

**REPORTS ON COMPLIANCE AND INTERNAL CONTROL**



Edward B. Hatchett, Jr.  
Auditor of Public Accounts

**Report on Compliance and on Internal Control Over Financial Reporting  
Based on an Audit of the General-Purpose Financial Statements  
Performed in Accordance With  
*Government Auditing Standards***

To the People of Kentucky  
The Honorable Paul E. Patton, Governor  
John P. McCarty, Secretary  
Finance and Administration Cabinet

We have audited the general-purpose financial statements of the Commonwealth of Kentucky as of and for the year ended June 30, 1999, and have issued our report thereon dated December 30, 1999. We conducted our audit in accordance with generally accepted government auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Several agencies were audited for internal control and compliance requirements in accordance with OMB Circular A-133 by other auditors whose reports thereon have been furnished to us, and our opinion presented herein, insofar as it relates to these agencies listed in the Appendix to this report, is based solely or partly on the reports of the other auditors.

Compliance

As part of obtaining reasonable assurance about whether the Commonwealth's financial statements are free of material misstatement, we performed tests of compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial instances of noncompliance, which we have reported to management.

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The Honorable Paul E. Patton, Governor  
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### Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Commonwealth's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Commonwealth's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 99-C&I-1, 99-CFC-2, 99-CFC-3, 99-FAC-4, 99-FAC-5, 99-FAC-6, 99-FAC-7, 99-FAC-8, 99-FAC-9, 99-FAC-10, 99-FAC-11, 99-FAC-12, 99-FAC-13, 99-FAC-14, 99-FAC-15, 99-FAC-16, 99-FAC-17, 99-FAC-18, 99-FAC-19, 99-FAC-20, 99-FAC-21, 99-GOT-22, 99-CHS-23, 99-CHS-24, 99-CHS-25, 99-CHS-26, 99-CHS/CDP-27, 99-CWD-28, 99-CWD-29, and 99-CWD-30.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider item 99-CWD-30 to be a material weakness. We also noted other matters involving the internal control over financial reporting, which we have reported to management.

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The Honorable Paul E. Patton, Governor  
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This report is intended solely for the information and use of management and applicable Federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report, upon release by the Auditor of Public Accounts, is a matter of public record and its distribution is not limited.

Sincerely,

A handwritten signature in black ink, appearing to read "Ed Hatchett", with a long horizontal flourish extending to the right.

Edward B. Hatchett, Jr.  
Auditor of Public Accounts

May 15, 2000





Edward B. Hatchett, Jr.  
Auditor of Public Accounts

**Report on Compliance With Requirements Applicable to Each  
Major Program and on Internal Control Over Compliance in  
Accordance With OMB Circular A-133 and on the  
Schedule of Expenditures of Federal Awards**

To the People of Kentucky  
The Honorable Paul E. Patton, Governor  
John P. McCarty, Secretary  
Finance and Administration Cabinet

Compliance

We have audited the compliance of the Commonwealth of Kentucky with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major Federal programs for the year ended June 30, 1999. The Commonwealth's major Federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major Federal programs is the responsibility of the Commonwealth's management. Our responsibility is to express an opinion on the Commonwealth's compliance based on our audit.

Several agencies were audited for internal control and compliance requirements in accordance with OMB Circular A-133 by other auditors whose reports thereon have been furnished to us, and our opinion presented herein, insofar as it relates to these agencies listed in the Appendix to this report, is based solely or partly on the reports of the other auditors.

The Commonwealth's general-purpose financial statements included the operations of the state universities, which expended \$287,831,292 in Federal awards that is not included in the Schedule of Expenditures of Federal Awards during the year ended June 30, 1999. The expenditure amount for Kentucky State University was not available and no expenditures relating to Kentucky State University have been included in the above amount. Our audit, described below, did not include the operations of the state universities because they engaged other auditors to perform an audit in accordance with OMB Circular A-133.

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We conducted our audit of compliance in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major Federal program occurred. An audit includes examining, on a test basis, evidence about the Commonwealth's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Commonwealth's compliance with those requirements.

In our opinion, based on our audit and the reports of other auditors, the Commonwealth complied, in all material respects, with the requirements referred to above that are applicable to each of its major Federal programs for the year ended June 30, 1999. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as items 99-CFC-42, 99-CFC-43, 99-CWD-44, 99-CWD-45, and 99-CWD-46.

#### Internal Control Over Compliance

The management of the Commonwealth is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to Federal programs. In planning and performing our audit, we considered the Commonwealth's internal control over compliance with requirements that could have a direct and material effect on a major Federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

To the People of Kentucky  
The Honorable Paul E. Patton, Governor  
John P. McCarty, Secretary  
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We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Commonwealth's ability to administer a major Federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 99-CFC-31, 99-CFC-32, 99-CFC-33, 99-CFC-34, 99-CFC-35, 99-CHS-36, 99-CHS-37, 99-TC-38, 99-CWD-39, 99-CWD-40, and 99-CWD-41.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major Federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

#### Schedule of Expenditures of Federal Awards

We have audited the general-purpose financial statements of the Commonwealth as of and for the year ended June 30, 1999, and we have issued a report thereon dated December 30, 1999. Our audit was performed for the purpose of forming an opinion on the general-purpose financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the general-purpose financial statements. Such information has been subjected to the auditing procedures applied in the audit of the general-purpose financial statements.

Several Schedules of Expenditures of Federal Awards were audited by other auditors whose reports thereon have been furnished to us, and our opinion presented herein, insofar as it relates to these agencies listed in the Appendix to this report, is based solely or partly on the reports of the other auditors.



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The general-purpose financial statements of the Commonwealth are prepared on an accrual/modified accrual basis of accounting. However, the Schedule of Expenditures of Federal Awards of the Commonwealth is prepared on the basis of cash disbursements as modified by the application of KRS 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed. Accordingly, the Schedule of Expenditures of Federal Awards is not intended to present the expenditures of Federal awards in conformity with generally accepted accounting principles.

In our opinion, based on our audit and the reports of other auditors, except for the effect of the application of a different basis of accounting as explained above, the Schedule of Expenditures of Federal Awards is fairly stated, in all material respects, in relation to the Commonwealth's general-purpose financial statements taken as a whole.

This report is intended solely for the information and use of management and applicable Federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report, upon release by the Auditor of Public Accounts, is a matter of public record and its distribution is not limited.

Sincerely,

A handwritten signature in black ink, appearing to read "Ed Hatchett", with a stylized flourish at the end.

Edward B. Hatchett, Jr.  
Auditor of Public Accounts

May 15, 2000

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999**

**SECTION 1 – SUMMARY OF AUDITOR’S RESULTS**

**Financial Statement Accounts**

Financial Statement Accounts: We issued an unqualified opinion on the Commonwealth’s general-purpose financial statements as of and for the fiscal year ended June 30, 1999.

Internal Control Over Financial Reporting: Our consideration of the Commonwealth’s internal control over financial reporting disclosed thirty reportable conditions. We believe that one of the reportable conditions is a material weakness. The reportable conditions and material weakness, which were disclosed during our audit of the general-purpose financial statements of the Commonwealth, are applicable to the following:

<u>AGENCY</u>	<u>NUMBER &amp; TYPE OF FINDINGS</u>	
	<u>REPORTABLE</u>	<u>MATERIAL</u>
Office of the Kentucky State Treasurer (99-C&I-1)	1	
Cabinet for Families and Children (99-CFC-2 and 99-CFC-3)	2	
Finance and Administration Cabinet (99-FAC-4, 99-FAC-5, 99-FAC-6, 99-FAC-7, 99-FAC-8, 99-FAC-9, 99-FAC-10, 99-FAC-11, 99-FAC-12, 99-FAC-13, 99-FAC-14, 99-FAC-15, 99-FAC-16, 99-FAC-17, 99-FAC-18, 99-FAC-19, 99-FAC-20, and 99-FAC-21)	18	
Governor’s Office of Technology (99-GOT-22)	1	
Cabinet for Health Services (99-CHS-23, 99-CHS-24, 99-CHS-25, and 99-CHS-26)	4	
Cabinet for Health Services/Custom Data Processing (99-CHS/CDP-27)	1	
Cabinet for Workforce Development (99-CWD-28 and 99-CWD-29)	2	
(99-CWD-30)		1

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 1 – SUMMARY OF AUDITOR’S RESULTS (CONTINUED)**

**Financial Statement Accounts (Continued)**

The reportable conditions and material weaknesses are presented in detail in Section 2 - Financial Statement Findings and Questioned Costs of the Schedule of Findings and Questioned Costs.

Compliance: In relation to the audit of the Commonwealth’s general-purpose financial statements, and the Schedule of Expenditures of Federal Awards, the results of our tests disclosed no instances of noncompliance that are required to be reported under generally accepted government auditing standards.

**Federal Awards and Schedule of Expenditures of Federal Awards**

Compliance: We issued an unqualified opinion on the Commonwealth’s compliance with the requirements applicable to each of its major Federal programs. However, the results of our auditing procedures disclosed five instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133. These findings are applicable to the following agencies of the Commonwealth:

<u>AGENCY</u>	<u>NUMBER OF FINDINGS</u>
Cabinet for Families and Children (99-CFC-42 and 99-CFC-43)	2
Cabinet for Workforce Development (99-CWD-44, 99-CWD-45, and 99-CWD-46)	3

The findings relative to compliance with requirements applicable to each of its major Federal programs are presented in Section 3 - Federal Awards Findings and Questioned Costs of the Schedule of Findings and Questioned Costs.

Internal Control Over Compliance: Our consideration of the Commonwealth’s internal control over compliance disclosed eleven reportable conditions. We believe that none of the reportable conditions are material weaknesses. The reportable conditions, which were disclosed during our audit, are applicable to the following agencies of the Commonwealth:

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 1 – SUMMARY OF AUDITOR’S RESULTS (CONTINUED)**

**Federal Awards and Schedule of Expenditures of Federal Awards (Continued)**

<u>AGENCY</u>	<u>NUMBER &amp; TYPE OF FINDINGS</u>	
	<u>REPORTABLE</u>	<u>MATERIAL</u>
Cabinet for Families and Children (99-CFC-31, 99-CFC-32, 99-CFC-33, 99-CFC-34 and 99-CFC-35)	5	
Cabinet for Health Services (99-CHS-36 and 99-CHS-37)	2	
Transportation Cabinet (99-TC-38)	1	
Cabinet for Workforce Development (99-CWD-39, 99-CWD-40, and 99-CWD-41)	3	

The reportable conditions relative to the Commonwealth's internal control over compliance are presented in Section 3 - Federal Awards Findings and Questioned Costs of the Schedule of Findings and Questioned Costs.

Schedule of Expenditures of Federal Awards: We issued a qualified opinion on the Commonwealth’s Schedule of Expenditures of Federal Awards because the schedule was presented on a basis of accounting that was not in conformance with generally accepted accounting principles as described in Note 1 of the schedule. The opinion was issued in relation to the Commonwealth’s general-purpose financial statements taken as a whole.

**Identification of Major Programs Audited**

OMB Circular A-133 defines a major program as “a Federal program determined by the auditor to be a major program in accordance with section \_\_.520 or a program identified as a major program by the Federal awarding agency or pass-through entity in accordance with section \_\_.215 (c).” Section \_\_.520 states, “The auditor shall use a risk-based approach to determine which Federal programs are major programs.” The following is a list of major Type A programs audited:

<u>CFDA #</u>	<u>Program Title</u>	<u>Expenditures</u>
<b>10.550</b>	Food Distribution	\$ 14,704,935
<b>10.551</b>	Food Stamps	337,546,433 a
<b>10.553</b>	School Breakfast Program	30,453,651 b
<b>10.555</b>	National School Lunch Program	96,903,989 b

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 1 – SUMMARY OF AUDITOR’S RESULTS (CONTINUED)**

**Identification of Major Programs Audited (Continued)**

<b>CFDA #</b>	<b>Program Title</b>	<b>Expenditures</b>
<b>10.556</b>	Special Milk Program for Children	91,146 b
<b>10.558</b>	Child and Adult Care Food Program	18,901,338
<b>10.559</b>	Summer Food Service Program for Children	2,984,855 b
<b>10.561</b>	State Administrative Matching Grants for Food Stamp Program	22,523,477 a
<b>11.550</b>	Public Telecommunication Facilities-Planning and Construction	1,392,339
<b>14.182</b>	Lower Income Housing Assistance Program – Section 8 New Construction/Substantial Rehabilitation	61,760,283 c
<b>14.228</b>	Community Development Block Grants/State’s Program	33,751,970
<b>14.239</b>	HOME Investment Partnerships Program	13,438,868
<b>14.855</b>	Section 8 Rental Voucher Program	3,859,034
<b>14.856</b>	Lower Income Housing Assistance Program – Section 8 Moderate Rehabilitation	1,281,131
<b>14.857</b>	Section 8 Rental Certificate Program	6,105,534
<b>15.250</b>	Regulation of Surface Coal Mining and Surface Effects of Underground Coal Mining	12,842,593 c
<b>15.252</b>	Abandoned Mine Land Reclamation (AMLR) Program	17,563,392
<b>17.207</b>	Employment Services	13,680,437 d
<b>17.225</b>	Unemployment Insurance	267,117,984
<b>17.245</b>	Trade Adjustment Assistance-Workers	17,003,538
<b>17.246</b>	Employment and Training Assistance–Dislocated Workers	19,113,516 e
<b>17.250</b>	Job Training Partnership Act	35,333,943 e
<b>17.253</b>	Welfare-to-Work Grants to States and Localities	3,269,952
<b>17.801</b>	Disabled Veterans’ Outreach Program (DVOP)	736,730 d
<b>17.804</b>	Local Veterans’ Employment Representative Program	792,300 d
<b>20.205</b>	Highway Planning and Construction	374,621,211

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 1 – SUMMARY OF AUDITOR’S RESULTS (CONTINUED)**

**Identification of Major Programs Audited (Continued)**

<b>CFDA #</b>	<b>Program Title</b>	<b>Expenditures</b>
<b>59.036</b>	Certified Development Company Loans (503 Loans)	783,273
<b>59.041</b>	Certified Development Company Loans (504 Loans)	24,324,971
<b>66.458</b>	Capitalization Grants for State Revolving Funds	24,865,703
<b>66.468</b>	Capitalization Grants for Drinking Water State Revolving Funds	369,261
<b>83.544</b>	Public Assistance Grants	15,641,339
<b>84.010</b>	Title I Grants to Local Educational Agencies	131,539,722
<b>84.027</b>	Special Education-Grants to States	50,704,123 f
<b>84.032</b>	Federal Family Education Loans	65,294,523 g
<b>84.069</b>	Leveraging Educational Assistance Partnership	311,937
<b>84.173</b>	Special Education – Preschool Grants	10,338,675 f
<b>84.203</b>	Star Schools	1,659,143
<b>93.558</b>	Temporary Assistance for Needy Families	117,943,708
<b>93.563</b>	Child Support Enforcement	36,648,622
<b>93.568</b>	Low-Income Home Energy Assistance	14,821,473
<b>93.575</b>	Child Care and Development Block Grant	38,541,798 i
<b>93.596</b>	Child Care Mandatory and Matching Funds of the Child Care and Development Fund	26,369,322 i
<b>93.658</b>	Foster Care-Title IV-E	47,029,861
<b>93.667</b>	Social Services Block Grant	48,429,972
<b>93.775</b>	State Medicaid Fraud Control Units	940,155 h
<b>93.777</b>	State Survey and Certification of Health Care Providers and Suppliers	3,450,907 h
<b>93.778</b>	Medical Assistance Program	1,988,466,000 h
<b>93.994</b>	Maternal and Child Health Services Block Grant to the States	14,157,274
<b>96.001</b>	Social Security–Disability Insurance	32,548,553 j
<b>NA</b>	FHA/VA Insured Loans	118,044,203
	Total Type A Programs	<u>\$4,371,099,718</u>

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 1 – SUMMARY OF AUDITOR’S RESULTS (CONTINUED)**

**Identification of Major Programs Audited (Continued)**

The following is a list of Type B programs audited as Major programs:

<b>CFDA #</b>	<b>Program Title</b>	<b>Expenditures</b>
<b>84.002</b>	Adult Education-State Grant Program	\$5,973,292
<b>84.278</b>	School-to-Work Implementation Grant	3,637,092
<b>93.044</b>	Special Programs for the Aging-Title III, Part B-Grants for Supportive Services and Senior Centers	1,342,861 k
<b>93.045</b>	Special Programs for the Aging Title III, Part C-Nutrition Services	2,685,461 k
<b>93.268</b>	Immunization Grants	<u>11,201,959</u>
Total Type B Programs Audited		<u>\$24,840,665</u>
Total Major Programs Audited		<u>\$4,395,940,383</u>

*Identified clusters include:*

- a – Food Stamp Cluster (Cabinet for Families and Children)
- b – Child Nutrition Cluster (Department of Education)
- c – Section 8 Project-Based Cluster (Kentucky Housing Corporation)
- d – Employment Services Cluster (Cabinet for Workforce Development)
- e – JTPA Cluster (Cabinet for Workforce Development)
- f – Special Education Cluster (Department of Education)
- g – Student Financial Aid Cluster (Kentucky Higher Education  
Assistance Authority, Cabinet for Workforce Development)
- h – Medicaid Cluster (Cabinet for Health Services)
- i – Child Care Cluster (Cabinet for Families and Children)
- j – Disability Insurance/SSI Cluster (Cabinet for Families and Children)
- k – Aging Cluster (Cabinet for Health Services)

**Dollar Threshold Used to Distinguish Between Type A and Type B Programs**

The maximum dollar threshold used to distinguish between Type A and Type B Programs was \$12,000,000. Certain component units and agencies audited by certified public accounting firms had lower dollar thresholds.

**Auditee Qualify as Low-Risk Auditee?**

The Commonwealth did not qualify as a low-risk auditee.



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS**

***Reportable Conditions Relating to Internal Controls and/or Compliance:***

**FINDING 99-C&I-1: Treasury Should Improve Procedures For Storing  
Supporting Documentation For The Reconciliation Process**

State Agency: Office Of Kentucky State Treasurer

During our review we noted that Treasury did not maintain adequate documentation for the clearing account reconciliation:

- Treasury did not maintain adequate documentation supporting the amounts recorded in the clearing accounts. The clearing accounts represent deposits in the bank for which Treasury has not yet received a pay-in-voucher (PIV), and thus, the deposits have not been recorded in the Statewide Accounting and Reporting System (STARS).
- Treasury could not reconcile the Commonwealth Concentration Clearing Account to supporting PIV documentation at June 30, 1999. The amount not reconciled totaled \$2,575,951 of the total \$82,642,068 in the account.
- Treasury, as part of the yearly closeout process, does not compile a detailed listing of the deposits comprising the clearing accounts. This is critical at June 30 because the information is needed to determine that cash on hand is fairly stated in the general-purpose financial statements.

**Recommendation**

We recommend Treasury document a detailed listing of each amount comprising each clearing account as part of their yearly June 30 closeout work. In addition, we recommend Treasury submit this listing as part of their monthly reconciliation package to the Office of the Auditor of Public Accounts for the month of June.

If Treasury cannot reconcile the account due to agencies not submitting PIVs in a timely manner, then Treasury should maintain a log noting which agencies are delinquent in their processing of PIVs.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-C&I-1: Treasury Should Improve Procedures For Storing  
Supporting Documentation For The Reconciliation Process (Continued)**

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**Management's Response And Corrective Action Plan**

*The Treasurer's Office does recognize and acknowledge that the use of a "clearing account" has been a weakness in the bank reconciliation process.*

*With the clearing account, totals of bank deposits, and not individual deposits, have been posted. Those totals would then be drawn down as Pay-In-Vouchers for individual agencies were posted to the accounting system. The unposted totals remaining in clearing were not identified by specific amounts. There has been no mechanism to do this. For reconciliation purposes, the detailed information would have to be gleaned manually from the daily deposit reports, picking out those items that had not been marked as being used. It is a highly manual process that "just grew" as the volume of electronic transactions has exploded over the last few years.*

*With the implementation of MARS on July 1, 1999, the clearing accounts as we have know them disappeared. MARS does contain some unclaimed deposit tables which, when fully operational, should be helpful in identifying individual deposits that have not been claimed or posted. The drawback to these is that the detailed data has to be entered manually into the tables, a very time-consuming task susceptible to human error, especially with limited personnel. There still is not an electronic interface between the bank records and the MARS accounts records that would allow automatic posting of deposits or an easy reconciliation of unposted amounts. This remains a very high priority goal in future MARS development.*

*The Treasury has high hopes that, once the "bugs" are worked out, the new MARS system will provide a better mechanism for tracking, identifying, and "aging" electronic deposits. If this happens, then the weakness associated with the old clearing accounts should ultimately disappear.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CFC-2: The Cabinet For Families And Children Should Maintain  
Accurate And Complete Documentation To Support Information Reported In The  
Commonwealth's Financial Statements**

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State Agency: Cabinet for Families and Children

The CFC prepares closing package documents at the end of each fiscal year to assist the FAC in preparing the Commonwealth's financial statements. Specifically, the ending balances reported in these documents are submitted to FAC and are used to compile the Commonwealth's Comprehensive Annual Financial Report.

We attempted to verify and test the reasonableness of CFC's accounts payable balances that were reported at year-end on the AFR-70 form to FAC. However, CFC was unable to show how they arrived at the year-end accounts payable balance reported to FAC in the AFR-70. Therefore, the accounts payable balance, as reported to FAC, is questionable. In addition, we noted the following problems with the information CFC was able to provide:

- The supporting documents provided by CFC did not agree in total to the amounts reported in the AFR-70. Because CFC did not maintain adequate and complete documentation to support the ending balances reported in the AFR-70, it is impossible to tell whether the existing payables were reported in the closing package at the appropriate dollar amounts.
- The vendor payment vouchers (P1 documents in MARS) and travel vouchers were prepared inconsistently. A number of P1s contained a reference number to the original contract, invoice number, or voucher number, while several of the P1s did not. Also, several of the vouchers CFC provided (in place of the P1) contained the date services were rendered, while many of them did not. Such information is necessary to verify the accounts payable balances reported at year-end by CFC. Without this information, there is no way to verify recorded payables, which existed at June 30, that were for goods or services authorized and received.

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CFC-2: The Cabinet For Families And Children Should Maintain  
Accurate And Complete Documentation To Support Information Reported In The  
Commonwealth's Financial Statements (Continued)**

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SAS No. 78 states, "The information system relevant to financial reporting objectives, which includes the accounting system, consists of the methods and records established to record, process, summarize, and report entity transactions (as well as events and conditions) and to maintain accountability for the related assets, liabilities, and equity. The quality of system-generated information affects management's ability to make appropriate decisions in managing and controlling the entity's activities and to prepare reliable financial reports."

"An information system encompasses methods and records that

- Identify and record all valid transactions.
- Describe, on a timely basis, the transactions in sufficient detail to permit proper classification of transactions for financial reporting.
- Measure the value of transactions in a manner that permits recording their proper monetary value in the financial statements.
- Determine the time period in which transactions occurred to permit recording of transactions in the proper accounting period.
- Present properly the transactions and related disclosures in the financial statements."

Because the accounts payable balance is only recognized at year-end, there is no system in place throughout the year to track payables, thus making it crucial for CFC to maintain accurate and complete accounting records to support all amounts reported to be reported to FAC.

**Recommendation**

CFC should maintain accurate and complete documentation to support the year-end information reported to FAC. CFC should also prepare the year-end information in a consistent manner. Also, to prevent similar problems in the future, CFC should:

**COMMONWEALTH OF KENTUCKY  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CFC-2: The Cabinet For Families And Children Should Maintain  
Accurate And Complete Documentation To Support Information Reported In The  
Commonwealth's Financial Statements (Continued)**

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**Recommendation (Continued)**

- Compile a file at year-end listing all payables to be reported, along with invoice numbers, contract numbers, or voucher numbers that would lead to the original invoice, contract, or voucher. This file should agree in total to the amounts reported on the AFR-70.
- Ensure every P1 has a number that traces back to the original invoice, contract, or voucher and ensure each voucher contains the date services were rendered to CFC.

**Management's Response and Corrective Action Plan**

*We disagree with the finding for the following reasons:*

- 1) On several occasions we explained to the auditor the methodology that was followed in determining the appropriate dollar amount of payables.*
- 2) We have attached copies of the workpapers that we used in arriving at the appropriate dollar amount for each Department's AFR-70. These workpapers do trace to the amounts as shown on the AFR-70s that were submitted to Finance and Administration Cabinet.*
- 3) To document further the amounts, in gathering our information, we had our employees to copy the screen of all payments that were made in the new year for old year services. These copies were provided to the auditor. Even though the invoice was not always included in this documentation, we reviewed each of these copies and found that 68% of these copies included in the "Description" field on the MARS screen an indication that the payment related to old year services, had the date showing on the voucher, or had a copy of the invoice attached. Enclosed are copies of these documents with the fields or invoice date highlighted. For those that did not have this information, the original invoice received from the vendor is filed in the area in which the payment was initiated.*

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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CFC-2: The Cabinet For Families And Children Should Maintain  
Accurate And Complete Documentation To Support Information Reported In The  
Commonwealth's Financial Statements (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

- 4) *We admit that not all PIs and other MARS payment documents were entered into the system consistently. The MARS system was new to each of us, and was "on-the-job training" for the majority of our employees. In addition, we were told by MARS Central not to use 99 in the "Budget FY" field on the documents as it was not properly working.*

**Auditor's Reply**

While we are aware of some of the problems associated with the implementation of MARS, and we sympathize with the agency as it works toward finding solutions to those problems, we believe our testing of this account is accurate. We received additional information, as indicated in the management response, and our review of those documents further confirmed our initial testing. Of seventeen items selected from the additional information, thirteen exceptions were noted. Thus, we emphasize the need for the agency to maintain accurate and complete documentation to support year-end information.

**COMMONWEALTH OF KENTUCKY  
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FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CFC-3: The Division Of Child Support Enforcement Should  
Retain Monthly Trial Balance Reports To Support The Accounts Receivable  
Balances Reported In The Financial Statements**

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State Agency: Cabinet for Families and Children

The Division of Child Support Enforcement (DCSE) prepares a closing schedule of accounts receivable at year-end which is used by FAC to compile the Commonwealth's financial statements. The closing schedule contains the amount of child support receivables estimated to be collected within 30 days. The accounts receivable estimate is based on the average monthly collections taken from Monthly Trial Balance reports generated by the Kentucky Automated Support and Enforcement System (KASES). DCSE calculates the estimate of receivables (less than 30 days) by taking the average of the previous twelve month's collections for each child support case type.

We attempted to verify the Monthly Trial Balance reports' accuracy and completeness by examining cases and payments within the reports DCSE used to calculate the accounts receivable estimate for FY 99. However, DCSE does not retain the individual case payment data for the totals reported in the Monthly Trial Balance. DCSE retains only the information on the total collections and collections by case type from the Monthly Trial Balance and does not store the detailed information of the case payments which are used to make up those totals. While individual case payment data is available for each case in the KASES system, it is impossible to determine what cases and payments were included in the Monthly Trial Balance figures.

CFC's failure to retain detailed payment information used in the Monthly Trial Balance reports prevents auditors or other interested parties from verifying the reasonableness of the accounts receivable (less than 30 days) estimate reported to FAC on the AFR-32 closing schedule and in the Commonwealth's financial statements.

Title 42 U.S.C. 654a (c) says the State Child Support Agency must "(1) use the automated (Child Support) system -- (A) to maintain the requisite data on State performance with respect to paternity establishment and child support enforcement in the State; and . . . (2) have in place systems controls to ensure the completeness and reliability of, and ready access to, the data described in paragraph (1) (A), and the accuracy of the calculations described in paragraph (1) (B)."

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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CFC-3: The Division Of Child Support Enforcement Should  
Retain Monthly Trial Balance Reports To Support The Accounts Receivable  
Balances Reported In The Financial Statements (Continued)**

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**Recommendation**

CFC should retain the detailed version of the Monthly Trial Balance reports for audit purposes and to support the accounts receivable balances reported in the AFR-32 and in the financial statements. The reports could be retained within an electronic database such as the Report Management Distribution System to ensure each Monthly Trial Balance can be easily verified against information in the KASES system and any other supporting document.

**Management's Response and Corrective Action Plan**

*KASES personnel have indicated they would be happy to review the case payment data with the auditor or any other employees in your Division and provide a demonstration of the information that is available. If the manner in which the case payment data is retained by KASES is not acceptable, we will make every effort to make the necessary changes to the system.*

**Auditor's Reply**

We look forward to the opportunity to discuss this situation with the agency staff during our FY 2000 audit.



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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-4: The Division Of Statewide Accounting Services Should  
Ensure Only Authorized Budgetary And Transaction-Specific Overrides Are Made  
To System Tables**

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State Agency: Finance and Administration Cabinet

Formal documented policies and procedures were not established in Finance and Administration Cabinet's (FAC) Division of Statewide Accounting Services (DSAS) to dictate the necessary authorization and procedures used to set up budgetary overrides. During the review of all budgetary control overrides in effect for the fiscal year, the auditor attempted to trace 647 date specific and warning overrides to properly authorized documentation. There were 151 overrides, or 23.3%, noted as exceptions; they are broken out as follows:

- Sixteen accounts were overridden without proper documentation on file with DSAS to substantiate the overrides. Two of these overrides were performed after a phone conversation requesting the change. No follow-up DOA-14s were received to support the two requests.
- Ninety overrides were originally requested only to override to a specified date. However, these accounts were improperly coded with warning indicators, which allows overrides to process indefinitely.
- Twenty-five accounts with warning overrides were found on file only for the establishment of the account. These documents did not include a request for a warning override indicator. No subsequent requests were in evidence.
- Allotment level overrides were not placed on twenty accounts even though requests were on file to do so. No documentation existed to explain why the overrides were not implemented.

In addition, formal documented policies and procedures were not established in DSAS to dictate restrictions on manual cash control overrides that DSAS authorizes on a transaction-by-transaction basis. DSAS and the Governor's Office for Policy and Management (GOPM) were operating under a verbal agreement whereby GOPM has responsibility for budgetary authority and the Controller's Office has the responsibility for cash management.

Potential causes for these problems are high turnover in the responsible positions and training that was insufficient to allow the operators to perform their jobs competently.

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-4: The Division Of Statewide Accounting Services Should  
Ensure Only Authorized Budgetary And Transaction-Specific Overrides Are Made  
To System Tables (Continued)**

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The failure of FAC to formally document policies concerning override authority could lead to a lack of understanding by both GOPM and DSAS personnel as to appropriate override procedures. Further, the failure to properly train FAC employees in the accepted policies and procedures pertaining to the override process could result in the budget control system not being properly maintained.

Written policies and procedures educate management and employees of their responsibilities and illustrate management concern for strong system integrity and continuity of policy implementation.

**Recommendation**

FAC should develop formal, written policies and procedures concerning budgetary and transaction-specific overrides. We are aware FAC will be changing from STARS to MARS for fiscal year 2000. These recommendations should, therefore, be incorporated into the policies and procedures being created for MARS. At a minimum, the following areas should be identified and developed into formal policies and procedures:

- Positions within FAC that can authorize overrides.
- Conditions under which an override would be allowed.
- Funds and types of accounts for which an override cannot be made.
- Required documentation for authorization of any override.
- Training procedures to familiarize employees that perform budget control override duties with the new MARS system.

In addition, FAC should review the original set up of budgetary overrides for fiscal year 2000 to ensure only those overrides specifically authorized by GOPM were established within the new MARS system.

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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-4: The Division Of Statewide Accounting Services Should  
Ensure Only Authorized Budgetary And Transaction-Specific Overrides Are Made  
To System Tables (Continued)**

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**Management's Response and Corrective Action Plan**

*Undocumented budgetary overrides are a breakdown in policy. The MARS Financial System operates in a similar fashion where budgetary overrides must be approved and documented coming out of GOPM. Accountants exercising professional discretion apply cash control overrides on a document level within the SAS General Accounting Branch. The Branch Manager approves account level overrides. Divisional policy is being developed and circulated concerning budgetary and cash overrides. Situations requiring cash control overrides are numerous and dependent on various short term circumstances.*

**COMMONWEALTH OF KENTUCKY  
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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-5: The Finance And Administration Cabinet Should Develop  
A Policy Requiring Employees To Use A Password-Protected Screensaver**

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State Agency: Finance and Administration Cabinet

FAC did not enable the automatic logoff feature available for the Customer Information Control System (CICS). In addition, there were no alternate policies or procedures formally issued by FAC to stop unauthorized access to applications from occurring when a session was active and unattended.

FAC decided the CICS automatic logoff feature was unsatisfactory due to the inconvenience it would cause users.

The failure to implement the CICS automatic logoff feature or alternate procedures, such as password-protected screen savers, provides an opportunity for unauthorized access to applications. Such unauthorized access could lead to loss of assets, interruption of services, and unauthorized data and program modifications.

Application systems that include critical or confidential information should automatically disable a session if no activity has occurred for a predetermined length of time. Alternately, if the application is not automatically disabled, it should be protected by another level of security, such as a password-protected screensaver, that is enabled after a specified length of inactivity. These features help safeguard assets and reduce the risk of misuse of an active session left unattended by the authorized user.

**Recommendation**

We recommend FAC enable the CICS automatic logoff feature. Alternately, we recommend FAC develop, approve, and issue a standardized policy regarding the use of a screensaver with password protection for all PCs. Additionally, all employees should be trained and required to follow this policy effective immediately after issuance.

**Management's Response and Corrective Action Plan**

*The financial application is employing the CICS logoff feature after 60 minutes. The procurement software doesn't provide for such a facility. We are currently designing the next generation software Advantage 3.0 that incorporates the purchasing module that will make it an option.*

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-6: The Division Of Statewide Accounting Services Should  
Follow Established Procedures To Ensure Only Authorized Changes Are Made To  
System Tables**

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State Agency: Finance and Administration Cabinet

Although previously reported in prior audits as “Other Matters,” our testing in the current year determined that the problems noted were more significant than in past audits. Our audit determined DSAS did not consistently follow established procedures to ensure only authorized changes were made to system tables. During the current year, two reviews were made of table maintenance procedures. First, a sample of fifty transactions within the Table Maintenance Activity Reports was reviewed for supporting and authorized documentation. The following specific weaknesses were noted:

- Thirty-three table maintenance actions out of a sample of fifty, or 66%, were not supported by documentation on file with DSAS.
- Five table maintenance actions out of a sample of fifty, or 10%, were deletions of Capital Project accounts that did not have sufficient support of the actual deletion of the accounts.

In addition, the Table Maintenance Activity Reports did not identify the user responsible for deletions from tables.

Second, a sample of 27 change requests, inclusive of 170 affected accounts, from the DSAS files was reviewed to ensure the requested changes were made to the system. The following specific weaknesses were noted:

- One of the change requests was an e-mail request for the establishment of an account. However, there was no follow-up Form DOA-14 received from GOPM in evidence.
- Two requests, inclusive of 16 accounts, were to delete the accounts. However, the accounts were not deleted or even presented in an “inactive” status.
- Two requests, inclusive of 7 accounts, completed by GOPM requested both an expiration date for the override to be placed on the account and for the cash control indicator to be changed from “Fatal” to “Warning.” However, for an override to a specific date to function properly the control indicator has to be

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-6: The Division Of Statewide Accounting Services Should  
Follow Established Procedures To Ensure That Only Authorized Changes Are  
Made To System Tables (Continued)**

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“Fatal.” In all seven cases, the expiration date was not used and the control indicators were changed to “Warning” for the Cash Control levels. This allowed overrides to occur indefinitely. No later requests were on file with DSAS to justify the “Warning” override. No corrections had been made.

Please note that these tested controls do not include controls over Budget Control Table overrides, which are covered in a separate finding.

Potential causes for these problems are high turnover in the responsible positions and training that was insufficient to allow the operators to perform their jobs competently.

FAC is the guardian of the system tables and is ultimately responsible for their integrity. They should be aware of all additions/deletions/changes made to the tables and of the appropriateness of all actions performed on the tables. Allowing accounts to be added/deleted/changed without proper authorization, or allowing these transactions to be made by unauthorized individuals, diminishes the integrity of the system tables.

**Recommendation**

In light of the transition from STARS to MARS at the beginning of fiscal year 2000, we recommend the following actions take place:

- DSAS should ensure the information residing on the STARS tables was completely and accurately represented in the new tables within MARS.
- DSAS should ensure similar levels of access restrictions for table modifications exist in the MARS environment that were in effect within STARS.
- DSAS should ensure there is a way of tracking table modifications within the MARS system similar to the Table Maintenance Activity Reports within STARS.

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-6: The Division Of Statewide Accounting Services Should  
Follow Established Procedures To Ensure Only Authorized Changes Are Made To  
System Tables (Continued)**

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**Recommendation (Continued)**

- DSAS employees should be made aware of all table maintenance related requirements and review modifications to restricted tables on a daily basis for accuracy and appropriateness. Any actions outside of the specified update authorizations should be investigated and findings documented.
- DSAS employees should be trained on the proper policies and procedures to follow when making modifications to system tables.

Further, all DSAS personnel should adhere to the established policy requiring Branch Manager approval of any changes made to accounts not requiring GOPM approval. This approval should be kept on file with other table maintenance related forms.

**Management's Response and Corrective Action Plan**

*An extensive data conversion effort was undertaken and documented cross walking the STARS table entries to appropriately populate the MARS tables. The MARS security structure limits access and update capabilities to tables to appropriate individuals. MARS is employing a DB2 application called Log Analyzer to capture table changes and produce daily reports on selected user updateable tables. The MARS system has many tables that are maintained by each agency, and updates to those tables are controlled by agency security requests. Division policy is being developed and circulated regarding centrally controlled table maintenance. The table maintenance process is evolving as we are testing and implementing the Desktop Workflow tools. Short-term documentation will take the form of Email and on-line entry, the longer term requests for table maintenance will be accomplished by routing the on-line entry to personnel possessing the appropriate security level to update the table with an Advantage Email note.*

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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-7: The Division Of Contracting And Administration Should  
Improve Internal Controls Relating To The Use Of Change Orders In Construction  
Contracts**

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State Agency: Finance and Administration Cabinet

During our internal control testing related to General Construction Capital Construction Projects for fiscal year ended June 30, 1999, we examined 29 General Construction (Minor Object Code E703) contracts. We noted specific internal control weaknesses related to Change Orders concerning eight of the contracts. Additionally, we noted possible weaknesses in overall internal controls of Change Orders due to the structure of standard terms and conditions common to all contracts examined.

Change Orders for six contracts contained insufficient documentation and/or explanation for the change from the original contract price. One of the six Change Orders lacked any approval signature.

- 1). PO-300735, Tuckpoint at Bluegrass Station:  
Change Orders 1 and 2 did not contain source documentation from the oversight entity (Architecture and Engineering Firm) or contractor related to the respective net increases of \$5,590 and \$4,862.
- 2). PO-315613, Swim Pool at EP Tom Sawyer:  
Change Orders 1 and 2 did not contain source documentation from the oversight entity or contractor related to the respective net increases of \$5,679 and \$1,265.
- 3). PO-327645, Microbial Contamination at CHR Building in Frankfort:  
Change Order 1 did not contain source documentation from the oversight entity or contractor related to the increase of \$5,899.
- 4). PO-332002, Lake Area Development:  
Change Order 1 did not contain source documentation from the oversight entity or contractor related to the increase of \$10,194.
- 5). PO-352051, Phase II Roederer Correctional:  
Change Order 2 was used to correct an “error made on PV transcode.” A copy of the PV was obtained from the Pre-Audit Division; however, no approval signature was on the DOA Advice of Change Form.



**COMMONWEALTH OF KENTUCKY  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-7: The Division Of Contracting And Administration Should  
Improve Internal Controls Relating To The Use Of Change Orders In Construction  
Contracts (Continued)**

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6). PO-359413, Gas Conversion Plant at Oakwood Hospital:

Change Orders 1 and 2 did not contain source documentation from the oversight entity or contractor related to the deletion and addition of subcontractors and changes to substantial completion date (Change Order 1) and the increase to the contract of \$6,627 (Change Order 2).

A Change Order for the following contract included possible unsubstantiated and/or unwarranted costs due to lack of work authorization and documentation by the oversight entity:

7) PO-365335, Fire Safety Upgrade, Westport Group Home:

The general contractor, MVS Construction Management, submitted documentation for Change Orders and completed work based on “prior authorization to proceed” and work that “subcontractors have already completed.” Notations on an April 2, 1999 letter from the general contractor to the oversight entity indicate that change orders were not substantially documented prior to the contractor performing the work.

A Change Order related to the following contract indicates a lack of cost control related to the standardized Change Order terms and conditions.

8) PO-37595[2]1, Ice Hockey Modifications for Freedom Hall:

The general contractor submitted Change Order 1 for \$18,207 for a materials purchase (switch gear) from a subcontractor. The general contractor added “overhead” of \$2,375 (adjusted price) on top of the undocumented subcontractor price for the switch gear purchase. The general contractor was awarded the maximum 15% rate of markup on a purchase of the materials that were already priced, including markup up by the subcontractor.

For all contracts reviewed that included Change Orders, we noted the standard Terms and Conditions of contracts do not require contractors to provide verifiable evidence of actual labor and materials costs for approved change orders. The change orders are, in essence, lump sum prospective estimates of expenditures – without materials invoices and/or detailed reports of labor costs. Thus, the basis or actual cost for which to apply markup percentage is not known.

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-7: The Division Of Contracting And Administration Should  
Improve Internal Controls Relating To The Use Of Change Orders In Construction  
Contracts (Continued)**

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When adequate justification is not provided by the requesting agency and/or unauthorized procedures are utilized for increases in the scope of projects and the resulting increase in expenditures, then unnecessary costs could be incurred by the Commonwealth. Additionally, inadequate documentation provided in contract folders could lead to improper allocation of funds due to the inability to verify change orders. Without definitive contract language requiring the contractors to present actual evidence of materials and/or labor cost, the Commonwealth may be making unnecessary expenditures in the Capital Projects Fund for overstated Change Orders.

200 KAR 5:311. Contract Modifications Section 2 states:

All changes or modifications to contracts for the purchase of commodities, supplies, equipment and construction services shall be effected by an advice of change order to the contract which shall be supported by the purchasing office documenting the reason and basis for the change or modification to the contract. A copy of the advice of change in order and the supporting documentation relative to any change or modification to a contract shall be filed and maintained in the contract file by the purchasing agency.

FAC Policy BO-111-11-00 Advice of Change in Order states in pertinent part:

The Advice of Change Order is not to be used to initiate major changes which are outside the original scope of the contract or to effect a new buy which normally would be placed by competitive bid.

The “Reason for Change” should fully support the basis for change and cite an appropriate contract provision. Supporting documentary evidence that validates the change must be attached.

**COMMONWEALTH OF KENTUCKY  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-7: The Division Of Contracting And Administration Should  
Improve Internal Controls Relating To The Use Of Change Orders In Construction  
Contracts (Continued)**

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The Official File Copy/Project Engineers General [Contract] Conditions, Changes in the Work, March 1, 1995 revision (representative example – common to most contracts), states in pertinent part that:

The value of any such change in the work shall be determined by one of the following methods:

- (1) By mutual acceptance of a lump sum (which should be properly itemized and with sufficient supporting data to permit evaluation; to encompass/include not to exceed 15% for overhead and profit of the actual cost of work), or
- (2) By unit prices stated in the Contract Documents or subsequently agreed upon; or
- (3) If none of the above methods are agreed upon; the Contractor, provided he receives an order as above, shall proceed with the work for which he shall be paid the net cost of said work, plus (15%) percent of such cost.

and, with respect to PO-375951:

It is agreed and understood that only one (1) fifteen percent (1 and 3 above) shall be added to the actual net cost of the work as defined herein, whether such work be done by the Prime General Contractor with his own forces or by his subcontractor, and any distribution thereof shall be work [sic] out between the Contractor and his subcontractor.

**Recommendation**

We recommend the Division of Contracting and Administration refrain from authorizing change orders that result in significant increases to the scope of the project or the funding required until adequate and thorough documentation is

**COMMONWEALTH OF KENTUCKY  
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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-7: The Division Of Contracting And Administration Should  
Improve Internal Controls Relating To The Use Of Change Orders In Construction  
Contracts (Continued)**

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**Recommendation (Continued)**

received from the entity requesting the change (the agency, contractor, or the architect/engineer). This documentation should be reviewed and evaluated by the Division of Contracting and Administration for reasonableness in order to determine the necessity of the change to the original contract. The documentation should be retained in the contract folder. We recommend the Division of Contracting and Administration strengthen the language of contract Terms and Conditions and require the contractors present evidence of actual materials and labor costs. Reliance on requirements that a contractor submit a statement (for all Change Orders over \$25,000) that it certifies to the best of its knowledge and belief the cost of pricing data submitted is accurate does not ensure the Change Order costs are/were actual expenditures made by the contractor.

**Management's Response and Corrective Action Plan**

*First, we want to dispel the notion that Change Orders are used to initiate major changes which are outside the original scope of a contract or to effect a new buy which normally would be placed by competitive bid. I believe these are the exact words used in your report. We would like to emphasize that we recognize the serious nature of using Change Orders and they are monitored closely by the Division of Engineering and Division of Contracting and Administration. However, Change Orders are a fact of life in the construction business.*

- *Discovery of unknown, covered conditions in projects that have to be dealt with.*
- *Errors and omissions that occur by the government agencies involved and/or the professional architect/engineering consultants that must be dealt with on projects.*
- *Use of Change Orders involving unit costs that were ask[ed] for and quoted in the bid documents.*
- *An array of various situations that surface where common sense dictates inclusion into contracts based on timeliness and cost.*

COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-7: The Division Of Contracting And Administration Should  
Improve Internal Controls Relating To The Use Of Change Orders In Construction  
Contracts (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*These are the most prevalent reasons and there are others. The Auditor must also understand that given the hundreds of projects we administer at any given time, out of necessity, the great percentage of Change Order decisions are being made by individual Department of Engineering Project Architects/Engineers in conjunction with our outside professional A/E consultants. Potentially troublesome Change Orders are discussed with the Director, Division of Engineering and/or Director, Division of Contracting and Administration prior to implementation. As indicated above, the great percentage of Change Orders are implemented in the "field."*

*This specific Audit component indicates a number of projects the Auditor has "written up" or pointed out problems with. The exact wordage being 'did not contain documentation from the oversight entity or contractor related to the respective net increases.' We agree that each and every Change Order should have backup from contractors acknowledging the pricing. The Division of Engineering can and will meet this requirement. Obviously, your concern is Change Orders with no backup. The second part of this relates to 'lack of documentation from the oversight entity (A/E firm).' The lower left hand corner of the Change Order is where the "A/E firm" note[s] their approval by signature and indicate the 'cost or pricing data submitted is accurate, complete and current.' If it is an agency project, then the agent signs here.*

*We concur that Change Orders should reflect all contract changes.*

*I am asking that the Project A/E's involved with the Westport Group Home and Ice Hockey Modifications for Freedom Hall projects review, research and respond to your comments.*

*We also concur that each Change Order and items on Change Orders contain brief explanations as to why the Change Orders are being initiated.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
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**FINDING 99-FAC-7: The Division Of Contracting And Administration Should  
Improve Internal Controls Relating To The Use Of Change Orders In Construction  
Contracts (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*The principal focus of this audit component is contained in Recommendation for Improvement' which states 'recommend that C/A strengthen the language of contract Terms and Conditions and require that the contractors present evidence of actual materials and labor costs.' As you are aware, we price our Change Orders three (3) ways – lump sum, unit prices and cost plus fifteen (15) percent. Without getting into a long written discussion here, we believe your recommendation is problematic. It is proposed that the management of our Department meet with management folks from the Auditor's Office to discuss your recommendation. In essence, we see your approach as creating a significant amount of paper work/time involvement going from 2<sup>nd</sup>, 3<sup>rd</sup>, tier subcontractors, subcontractors, material/equipment suppliers, general contractors through consultants, our payment process, etc. Just being able to interpret labor costs is going to be a complicated significant feat. This approach is also not going to be reflective of what is actually occurring with some projects.*

*In the final analysis, our private architect/engineering consultants review Change Order costs plus the Department's own Architects/Engineers do the same. The end result is acceptable, competitive Change Order pricing.*

*Response provided by Danny Shearer, Director, FAC Department of Facilities Management, Division of Contracting and Administration*

**Auditor's Reply**

With respect to the agency reply concerning Change Order language in the Contract Terms and Conditions statements provided with all awarded contracts we respond as follows:

We believe our audit findings demonstrate the need for FAC to strengthen Change Order cost control by requiring contractors to substantiate costs, particularly for large-dollar Change Orders. We note Management's Response and Corrective Action Plan concerning the contracted A/E oversight entity and its

**COMMONWEALTH OF KENTUCKY  
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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
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**FINDING 99-FAC-7: The Division Of Contracting And Administration Should  
Improve Internal Controls Relating To The Use Of Change Orders In Construction  
Contracts (Continued)**

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**Auditor's Reply (Continued)**

duty to ensure pricing data. The Change Orders require A/E signatories agree that it is "[t]o the best of my knowledge and belief, the cost or pricing data submitted is accurate, complete and current." However, there is no express requirement that any detailed demonstration of actual costs or pricing data be submitted along with the Change Order. As the process now stands, only a brief, single-line tabulation of labor, materials and "mark-up" is required. Backup documentation provided with the tabulations is minimal or nonexistent.

The Change Orders are merely prospective statements, or estimated costs, and might not represent actual costs incurred by a contractor. An oversight entity can only evaluate, in a broad sense, the reasonableness of the additional costs associated with any given Change Order and approve or disapprove of the request. Change Orders are often complex in nature and may contain many labor hours and/or materials. We do not agree the process currently employed by FAC's Divisions of Engineering and/or Contracting and Administration provides an accurate and verifiable statement of cost. The "cost plus fifteen (15) percent" method is the usual way of pricing the changes. Without a basis to verify actual cost, the 15% markup is nebulous and possibly without merit, i.e. contractors may be receiving a mark-up twice.

The sort of "professional judgement" rendered by oversight entities and in-house staff should not be a substitute for Change Order cost verification and may fall far short of exactitude. Labor costs are verifiable by hourly wage rates and employee identification and materials costs can be demonstrated by presentation of actual invoices. There is little incentive for a contractor to control Change Order costs unless it is required to provide proof of costs incurred, at least in summary form, in addition to the standardized Change Order form.

We acknowledge Mr. Shearer's proposal that concerned management of FAC and APA meet to discuss the matter further. We will forward Mr. Shearer's request and comments concerning the Change Order process to the APA's Director of the Division of Financial Audit.

**COMMONWEALTH OF KENTUCKY  
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FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-8: The Division Of Contracting And Administration Should  
Ensure Established Policies For All Capital Construction Bid Requirements Are  
Followed**

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State Agency: Finance and Administration Cabinet

We examined twenty-nine General Construction (Minor Object Code E703) contracts during our internal control testing related to General Construction Capital Construction Projects for the fiscal year ended June 30, 1999. We noted internal control weaknesses related to three of these contracts as follows:

- 1). PO-353044/ES-107-99, Kentucky Center for the Arts:  
The contract bid file indicated bid information was mailed to seven potential bidders instead of ten as is required by Policy and Procedure BO-220-12.
- 2). PO-318693/ES-24-99, HVAC at Somerset National Guard:  
Engineering File No. Z-542, Section 0100 – Time of Completion, contains incomplete and/or missing information concerning substantial completion date(s). The Contract Terms do not include the completion date(s). Notes to the file indicate the error was detected. A letter from the bond/insurance carrier indicated an HVAC contractor was behind on completion. Additional correspondence concerning a tile contractor indicates a new tile subcontractor was required due to tile work completion problems.
- 3). PO-451027/ES-257-99, Replace Cottages at Carter Caves:  
The Contract File was missing for this contract and could not be located by Contracting and Administration staff.

In the case of the first item, Policy and Procedures require a minimum of ten firms should be mailed Invitation to Bid Notices for Advertisement and Construction. Soliciting this minimum number provides for a more competitive bid environment. When fewer contractors are solicited, the Commonwealth cannot be assured bid prices are reasonably competitive. If, due to specialization and/or limited availability of contractors, fewer than ten contractors are available, then Contracting and Administration should document reasons for the limitation.



**COMMONWEALTH OF KENTUCKY  
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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-8: The Division Of Contracting And Administration Should  
Ensure Established Policies For All Capital Construction Bid Requirements Are  
Followed (Continued)**

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In the case of the second item, Contracting and Administration should fully state substantial completion information in the contents of contract Terms and Conditions in order to ensure contractors and subcontractors are made aware of substantial completion deadlines and potential consequences. Without these internal controls, Contracting and Administration may encounter delays, increased costs, and legal imperilment.

In the case of the third item, without full utilization of computer resources/storage systems, pay ledgers and Change Order information contained in contract files is not readily available and secure.

FAC Policy and Procedure BO-220-12-00 Section 1 states, in pertinent part, that the advertisement process for construction project competitive sealed bidding for construction shall include a minimum of ten firms indicating a desire to bid the type of project.

The term “substantial completion” is usually defined in contract Terms and Conditions, along with procedures for documenting substantial completion and substantial completion date(s). Engineering File Z-542 for the Somerset National Guard Armory, Section 01010 –Time of Completion contains no recognizable completion date. Notes to the file indicate “[t]here is no final completion date” and “[t]here is not mention of liquidated damages.”

**Recommendation**

When fewer than ten capable contractors are available, we recommend that Contracting and Administration fully document efforts to secure interested and available contractors. We recommend Contracting and Administration increase internal controls to ensure all contracts are assigned a substantial completion date and liquidated damages terms in the Official Bid. Additionally, Contracting and Administration should locate and/or reassemble missing Contract File information for ES-257-99 and continue with its current efforts of computerizing the Contract File storage system.

COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-8: The Division Of Contracting And Administration Should  
Ensure Established Policies For All Capital Construction Bid Requirements Are  
Followed (Continued)**

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**Management's Response and Corrective Action Plan**

1. PO-353044/ES-107-99 – Kentucky Center for the Arts

*Response:*

*This procurement solicited chiller manufacturers. There are not ten (10) of these type firms (chiller manufacturers) to bid the project. In the future, we will place a memo in the file indicating when ten (10) potential bidders are not available.*

2. PO-318693/ES-24-99, HVAC-Somerset National Guard

*Response:*

*This procurement resulted in one (1) bid/bidder. The bid document should contain substantial completion date and then a final completion date. After sometime[sic] on the project, it became apparent the contractor was having performance problems. We involved the contractor's payment/performance bond carrier to encourage the contractor to do better or the carrier complete the project for the contractor. In the end, the Department [Engineering and Contracting and Administration] assisted the contractor in the required management, administration necessary to complete the project. It maybe[sic] the tile subcontractor and tile manufacturer were replaced. Our objective was to complete the project in a timely manner. Any changes in the completion dates, subcontractors, materials should have been followed up with Change Orders recognizing such. Given the great difficulty with the contractor's performance and our intense involvement with his job tasks, our focus was on doing those things that was relative to project completion.*

3. PO-451027/ES-257-99, Replace Cottages-Carter Caves

*Response:*

*We have renovated the Division of Engineering and Division of Contracting/Administration over the last years. This involved relocating thousands of files, obviously we lost this file and are trying to find it.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-8: The Division Of Contracting And Administration Should  
Ensure Established Policies For All Capital Construction Bid Requirements Are  
Followed (Continued)**

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**Auditor's Reply**

With respect to the first item we respond as follows:

We appreciate FAC's efforts to ensure memorandums justifying noncompliance with FAC policy are included in its files. We note that the Thomas Register of American Manufacturers currently lists 190 companies under the "chiller" heading. It is beyond the scope of this reply for us to either confirm or deny FAC's claim that less than 10 exist. We recommend Contracting and Administration and Engineering increase efforts to comply with FAC policy by utilizing internet resource devices such as the Thomas Register in order to ensure many prospective bidders are made aware of contracts. Buyers and other concerned individuals within Contracting and Administration and Engineering should include documentation of bid solicitation to the fullest extent practicable.

With respect to the second item we respond as follows:

We acknowledge the difficulties related to this contract; however, we encourage FAC to insist all completion dates are included in bid documents in order to ensure the Commonwealth's risk of imperilment is minimized.

With respect to the third item we respond as follows:

Document loss could be reduced by properly maintained electronic storage. We understand the difficulty in maintaining large amounts of hard-copy files and we encourage FAC to fully utilize its electronic storage capability. We note that there is much duplicate information in the three General Construction files. The "Contract Files" include ledger/payment documents. The "Engineer's Files" and "ES" prefixed files contain various other documents. There is no comprehensive repository of contract information. Engineering, Contracting and Administration, and Accounting staff might benefit from electronic consolidation of records and elimination of duplicate paperwork. We also note that many of the Engineering files are archived in a mechanical storage tower that was inoperative at the time of audit.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-9: The Finance And Administration Cabinet Should  
Implement Policies And Procedures For Maintaining Adequate Supporting  
Documentation For All Expenditure Transactions**

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State Agency: Finance and Administration Cabinet

We selected 42 Capital Construction (02 Fund) expenditure transactions for examination of expenditure internal control attributes. Of the 42 items, 15 were identified as Price Contract transactions. We could not locate any delegation of Pre-Audit authority that would provide for agency verification of Price Contract terms and conditions and prices related to the 15 Price Contracts examined. Our examination revealed weaknesses in internal controls and/or noncompliance with Kentucky Statutes related to Price Contract procurements. FAC's Pre-Audit Division is responsible for verification of Price Contract dollar amounts and terms and conditions of expenditures made under such. We requested Invitations to Bid from the Division of Purchases in order to verify the information entered into the Kentucky Automated Purchasing System (KAPS) fields was in agreement with the latest Price Contract catalog amount. We tested for agreement with the following attributes:

- 1). Bid Invitations were at the Division of Purchases and indicate that Price Contracts where competitively bid.
- 2). Price lists and/or catalogs where available at the Division of Purchase and up-to-date with contract terms and conditions.
- 3). Price Contract terms and conditions agreed with vendor invoices.
- 4). Price Contracts were on file with FAC's Pre-Audit Division.
- 5). Price Contract catalogs available at FAC's Pre-Audit Division were complete and up-to-date with contract terms and conditions.

Inconsistencies and/or lack of agreement with the aforementioned attributes is noted as follows:

- 1). Invitations to Bid (IT documents) and source documentation for Price Contracts could not be located for 13 of the 15 Price Contract Purchase Orders.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-9: The Finance And Administration Cabinet Should  
Implement Policies And Procedures For Maintaining Adequate Supporting  
Documentation For All Expenditure Transactions (Continued)**

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Staff within the Division of Purchases attempted to retrieve archived files from the Department for Libraries and Archives related to the contracts. The files for the 13 contracts had been prematurely archived. The two Price Contract files available were filed in bulk by IT number and were difficult to retrieve in total. The files contained much superfluous information (such as vendor annual reports) and were in no particular order.

2) & 3).

Price Catalogs are used to maintain up-to-date price and description information for Capital Construction Price Contracts. The Capital Construction Price Contracts are unique among Price Contracts in that they often last for more than one year. Price catalogs provide a means of verifying current terms and conditions. No price catalogs were available at the Division of Purchases, which were contemporaneous with the audit period. Purchases staff informed us that only agency personnel would have up-to-date price catalogs. Thus, FAC's Division of Purchases has no way to determine if KAPS document fields are entered correctly. Instead, they must rely on agencies and/or delegated pre-audit authorities to verify current prices.

4) & 5).

FAC's Pre-Audit Division files/contract books were checked for verification of price contract terms and conditions and current prices. Five of the fifteen items tested had Price Contracts on file.

None of the fifteen items had Price Contract catalogs filed with Pre-Audit that were contemporaneous with the audit period.

KRS 171.450 requires the Kentucky Department for Libraries and Archives, by administrative regulation, to establish standards and procedures for the retention, disposal, and destruction of public records.

725 KAR 1:030 requires each authority of state government to dispose of records as outlined in "State Records Retention and Disposal Schedules," a system developed by the Public Records Division of the Department.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-9: The Finance And Administration Cabinet Should  
Implement Policies And Procedures For Maintaining Adequate Supporting  
Documentation For All Expenditure Transactions (Continued)**

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The current “Records Retention Schedule,” adopted by the Department in December 1995, states, on page 4, under the heading “Auditable Records:”

Unless otherwise supported by Kentucky Revised Statutes or federal regulations specifying a longer period, the retention requirement for records subject to audit, as approved by the Auditor of Public Accounts, is **three** years. (Emphasis in original)

Without ready access to Capital Construction Price Contracts and related documentation, FAC is not able to verify terms and conditions of Capital Construction Price Contracts. Taxpayers and/or other concerned parties are not able to verify the contracts and ensure competitive bid procedures where employed. Additionally, the Auditor of Public Accounts is not able to perform audit functions related to the Price Contracts.

Additionally, Price Contracts for Capital Construction are updated periodically. Changes in prices and terms and conditions may be verified through the use of catalogs provided by contracted vendors. According to Division of Purchases staff, the catalogs are provided only to the agencies. Without up-to-date catalog pricing and/or a computer data base that defaults to preset, updated price fields, there is no method for FAC’s Pre-Audit Division and/or the Division of Purchases to verify prices on invoices provided by vendors are in agreement with awarded contracts.

We base our findings on the following criteria:

- Pre-Audit Authority listings provided by FAC Pre-Audit Acting Branch Manager
- BO-120-13-00 Pre-Audit functions, (decentralization of)
- KRS 171.410 to KRS 171.740 concerning public records

**Recommendation**

We recommend FAC’s Division of Purchases recognize Capital Construction project Price Contracts are often longer than one year in duration and that they retain these Price Contracts for three years or until audited. Any archived materials should be stored in an orderly manner and free from superfluous materials.

**COMMONWEALTH OF KENTUCKY  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-9: The Finance And Administration Cabinet Should  
Implement Policies And Procedures For Maintaining Adequate Supporting  
Documentation For All Expenditure Transactions (Continued)**

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**Recommendation (Continued)**

We recommend FAC employ a method of obtaining and retaining Price Contract catalogs for Pre-Audit purposes. We recognize the Pre-Audit delegations available under BO-120-13-00; however, we recommend FAC retain materials related to the Pre-Audit functions. BO-120-13-00 provides that “[p]eriodic post-audit checks will be made to ensure the integrity of the documents.” The post-audit checks are best facilitated by use of up-to-date and complete Price Contract materials.

We recognize the KAPS system is no longer employed; however, we note that Price Contract dollar fields could be entered (for the items tested) by agencies making Capital Construction purchases. If practicable under the MARS system, we recommend a centralization and verification system by which current Price Contract item prices default to pre-set and verified fields.

**Management’s Response And Corrective Action Plan**

*The contracts referenced as missing from FAC Pre-Audit were KAPS Contracts for which we do not verify prices as they are fixed by the contract in KAPS. Under MARS the price contract information is stored in the system and can be reported from as updated.*

**Auditor’s Reply**

FAC’s response falls far short of addressing our concerns. The statement provided appears to be specific to Items 4 and 5 only. No Management’s Response and Corrective Action Plan concerning other items was received.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-10: The Finance And Administration Cabinet Should  
Improve Internal Controls Over Capital Construction Expenditure Transactions**

State Agency: Finance and Administration Cabinet

During our review of Capital Construction Projects, we selected 42 Capital Construction (02 Fund) expenditure transactions for examination of expenditure internal control attributes. Within our test for various attributes related to internal controls, we noted certain items that were not in agreement with good internal controls and accounting procedures and which might compromise FAC's ability to effectively monitor and control its Pre-Audit duties and responsibilities. Our findings are as follows:

- 1). KAPS Division of Accounts (DOA) forms were not complete, signed by FAC and/or agency authority, and/or lacked "FAC "date received" stamps. Ten of the forty-two items tested lacked requisite signatures and/or FAC date stamp marks. We also noted the Director of the Division of Accounts' signature stamp is not initialed or otherwise identified by the FAC Pre-Audit staff member using the stamp, and there are no apparent dollar amount parameters for the use of the stamp.
- 2). We noted one case concerning FAC's Contracting and Administration Division for a Capital Construction E703 expenditure where the vendor submitted an invoice for payment prior to approval by Contracting and Administration staff. This action indicates the work was likely performed by the contractor prior to formal approval by the FAC Project Engineer.
- 3). We noted two items for which three quotes were called for per FAC policies BO-220-10 and BO-111-55-00. The quotes were not provided by the agency.
- 4). We noted one case for which the warrant was not submitted to the Treasurer in a timely manner as required by KRS 45.456. This statute requires FAC transmit the warrant within 10 days and for which the vendor may have been eligible for KRS 45.458 late payment penalty payment by the state.
- 5). We noted one case for which the KAPS DOA form could not be located at FAC Pre-Audit and had to be provided by the agency.



**COMMONWEALTH OF KENTUCKY  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-10: The Finance And Administration Cabinet Should  
Improve Internal Controls Over Capital Construction Expenditure Transactions  
(Continued)**

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- 6). We noted one case for which the invoice total dollar amount was indeterminate and could not be tied to the KAPS DOA Form total of \$993.
- 7). We noted one case for which freight/transportation charges were paid on an invoice in possible violation of BO-111-46-00, which encourages agencies to require vendors to provide actual shipping charges and specify “F.O.B. Destination Freight Prepaid.”

The effect of the above measures of compliance is presented respectively as follows:

- 1). KAPS documents (DOA forms) contain signature blocks for authorized agent/date, employee receiving material, and FAC approval signatures. Additionally, date received stamps are placed on the back of the KAPS DOA forms. The signatures provide a reasonably verifiable audit approval trail only if fully utilized. The use of signature stamps is not verifiable and possibly not legally enforceable. Additionally, the signature stamp approval process employed does not provide for limitations of approval based on dollar amount parameters in that the stamp may be used regardless of the dollar amount. In effect, the Division Director’s signature stamp might just as easily be pre-printed on the KAPS DOA forms and distributed to authorized users – a method we do not recommend.
- 2). General Construction E703 expenditure work requiring advise and/or approval by Project Engineers should only be undertaken after formal approval by Contracting and Administration staff. The occurrence of events related to this transaction may indicate certain controls are lacking in order to ensure contractors do not go ahead with work until the approval process is complete.
- 3). The policy cited requires that state agencies shall informally obtain three or more price quotations from qualified sources for purchases estimated to cost between \$3,000 and \$10,000 (\$15,000, Dept. of Parks). Further, Policy BO-111-55-00 requires the price quotations to be forwarded, with payment documents, to FAC. Without verification of quotes, the Commonwealth cannot be assured an agency has made an effort to secure the best price for goods or services.

**COMMONWEALTH OF KENTUCKY  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-10: The Finance And Administration Cabinet Should  
Improve Internal Controls Over Capital Construction Expenditure Transactions  
(Continued)**

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- 4). Prompt processing of Purchases Orders is necessary to ensure the state does not incur additional expenses due to imposition of late payment penalties.
- 5). FAC's Pre-Audit Division is responsible for maintaining source document invoices and Purchase Orders. These documents are necessary for paper-trail audit verification. We acknowledge that high turnover of temporary filing staff may have caused filing errors and losses and that MARS implementation will likely remedy storage and filing requirements.
- 6). The Pre-Audit Division should document reconciliation of questionable and/or confusing invoice totals. The invoice in question contains hand notations and line-outs of balances and is stamped "only invoice available." Without further verification, we could not agree the purchase order total with the invoice.
- 7). The policy cited requires agencies to make purchases sans shipping costs. If a vendor does not agree, purchasers are encouraged to secure documentation of actual costs from vendors. Without vendor responsibility for shipping costs and proper F.O.B. title designation, the Commonwealth cannot be ensured vendors assume risks and costs of possible goods losses and damages.

**Recommendation**

All Items –

We recognize the implementation of MARS and the phase out of KAPS will provide for a different set of internal controls related to expenditures and Purchase Order procurement internal control procedures. The recommendations that follow should be incorporated, when possible, within the MARS system.

- 1). We recommend FAC fully update its Policy and Procedures Manual in order to incorporate any remaining manually generated signature documents.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-10: The Finance And Administration Cabinet Should  
Improve Internal Controls Over Capital Construction Expenditure Transactions  
(Continued)**

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**Recommendation (Continued)**

- 2). We recommend Pre-Audit communicate our findings to Contracting and Administration related to this item. Contracting and Administration should ensure contractors do not begin work until fully authorized by Project Engineering staff.
- 3). We recommend three quotes for Capital Construction purchases, in accordance with Policy and Procedure Manual limits, be provided to Pre-Audit, along with invoices and Purchase Orders.
- 4). We recommend Pre-Audit ensure warrants are transmitted according to the statutory requirements.
- 5). We recommend Pre-Audit retain source document invoices and Purchase Orders as required.
- 6). We recommend Pre-Audit verify questionable invoices and include comments with the requisite paperwork.
- 7). We recommend Pre-Audit investigate the value and use of the shipping charge policy and make changes to exclude commonly purchased, low dollar amount and/or shipping cost items. Otherwise, we recommend Pre-Audit notify agencies of noncompliance and request that they insist on vendor responsibility for shipping costs and risks.

**Management's Response And Corrective Action Plan**

*Policy & Procedure Manuals are underway, but will take some time to complete. We will forward the communication to Facilities regarding the commencement of work prior to Engineering authorization. The documentation requirements will be in the Pre-Audit Procedures for agencies.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-10: The Finance And Administration Cabinet Should  
Improve Internal Controls Over Capital Construction Expenditure Transactions  
(Continued)**

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**Auditor's Reply**

We encourage FAC to continue with its plans and to expedite new policy and procedures manuals as soon as possible.

With respect to the matter concerning Engineering, we have brought the matter to FAC Engineering staff. We included the finding here due to the fact the backup documentation was provided by FAC's Pre-Audit Division in response to our testing of matters within its purview.

We note FAC did not respond completely to findings noted in this Record of Control Weakness.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-11: The Finance And Administration Cabinet Should  
Improve Efforts In Effecting Equal Employment Opportunity Contract Compliance**

State Agency: Finance and Administration Cabinet

During our review of Capital Projects, we selected 29 General Construction (E703) Capital Construction projects for Contracting and Administration Review. Of these 29 contracts, 16 were over \$250,000 and possibly subject to the Kentucky Equal Employment Opportunity (EEO) Act provisions of KRS 45.560 to 45.640. Some of the contracts/contractors examined were excluded from certain statutory provisions due to employment of fewer than eight employees. We noted seven noncompliance issues related to reporting compliance or breach for certain contracts as follows:

- 1). Contractors/contracts that are not able to secure a reflective percentage of minority workforce (as verified by 1990 census data) are not required to fully comply with the provisions of KRS 45.600(6). This section of the statute requires contractors “certify by verified affidavit” that they have made reasonable effort to comply with percentage of employment requirements. No affidavit was located in the contract file for the contract (ES-188-99).
- 2). Of the contractors/contracts, for which compliance with KRS 45.560 through 45.640 was required, the Office of EEO/Contract Compliance maintains a Federal form CC-257 (or facsimile) that provides minority employment information. These forms, as utilized throughout the audit period, do not contain detailed reports of hire dates and county and state of residence for each employee as is required.
- 3). Affidavits of Completion are maintained by Contracting and Administration; these affidavits are not contained in the EEO compliance folders. Instead, the Office of EEO/Contract Compliance relies on statements/letters from contractors that contracts are complete. Contracting and Administration does not forward Affidavits of Completion to the Office of EEO/Contract Compliance.
- 4). For all of the contracts tested, the Office of EEO/Contract Compliance must rely on reports generated by Contracting and Administration as a means of verifying that the contracts are over \$250,000 and thus subject to compliance laws. We could not locate a notation of contract ES-25-99 on the Contracting and Administration Project Award Log that was forwarded to the Office of EEO/Contract Compliance and there was no effort to monitor EEO compliance.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-11: The Finance And Administration Cabinet Should  
Improve Efforts In Effecting Equal Employment Opportunity Contract Compliance  
(Continued)**

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- 5). Subcontractors, working for general contractors awarded contracts, are required to comply with KRS 45.560 to 45.640 provisions. One of the contracts, ES 114-99, contained no request for subcontractor names. Additionally, the request letters provided by the Office of EEO/Contract Compliance are styled such that a non-response might be inferred to mean no subcontractors are utilized.
- 6). We noted one case of continued noncompliance, contract ES-188-99. The contractor was notified repeatedly of violations but no legal action and/or withholding of payment was undertaken.
- 7). The Office of EEO/Contract Compliance does not make site visits or otherwise exercise its right to access all books and records pertaining to contractor employment practices as provided per KRS 45.610. No site visits or requests to access contractor books or records were made for any of the contracts tested. It is our understanding that, due to limited staff, in depth examinations and/or audits of the sort contemplated by the law are not undertaken.

The effect of the seven comments above follows in respective order:

- 1). Without certification of contractors' statements, FAC cannot be assured that the contractors are presenting actual statements of compliance efforts to the fullest extent practicable. Contractors may be less cavalier about embellishing compliance statements if they are required to present affidavits as required by the law.
- 2). FAC cannot be assured of full compliance when it utilizes reporting forms that do not require contractors provide complete names, addresses and hire dates of employees. Additionally, verification of contractor compliance statements may be difficult or impossible.
- 3). FAC Contracting and Administration maintains Affidavits of Completion for all General Contracts. These affidavits provide a verifiable basis for determining if contracts are still open. The Office of EEO/Contract Compliance cannot be assured contracts are closed if they rely on letters and/or statements made by contractors.

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
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- 4). The Office of EEO/Contract Compliance cannot be assured of complete contract award information unless it is provided, or otherwise obtains by its own methods, a verifiable listing of all bids. In this case, a contract was awarded and no effort was made to verify compliance with Equal Opportunity Act Laws.
- 5). The form letter used throughout the audit period does not require that contractors state “none” or otherwise indicate no subcontractors are used. By relying on non-response as an indication no subcontractors are employed, the Office of EEO/Contract Compliance cannot be assured subcontractors are not used and/or the contractor has presented complete information.
- 6). Failure to comply with KRS 45.560 to KRS 45.640 may result in cancellation or termination of contracts. The noncompliant contractor was repeatedly mailed requests for reporting information and was repeatedly remiss in responding to the requests. We could not locate documentation indicating the contractor was threatened with any legal action or recourse available under the statutes. Without providing forthright threat of this cancellation and/or legal action substantiating unlawful practice, contractors may be reticent to comply with minority workforce utilization requirements.
- 7). Site visits and records examinations are provided within the statutes. None were undertaken during the audit period. Effective internal controls would allow for verification of contractor claims by undertaking field examinations as audit measures for cases of noncompliance.

Criteria considered in our review of the problems indicated above is briefly discussed below:

- 1). KRS 45.600 (6) states:

If the bidding party's work force is not reflective of the percentage of minorities in the drawing area and he [it] has complied with all other affirmative action requirements in KRS 45.560 to 45.640, he may certify by verified affidavit

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
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(Continued)**

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that he has made every reasonable effort to comply with said percentage requirements, and he shall thereafter be entitled to all the benefits of KRS 45.560 to 45.640.

- 2). KRS 45.600 (1) (b) states that the following information shall be submitted to the cabinet:

A breakdown of the bidding party's existing workforce, indicating the race, sex, age, position held, county and state of residence, and date of employment of each employee.

- 3). Affidavits of completion are required and maintained by Contracting and Administration. Good internal controls and reporting procedures would dictate the Office of EEO/Contract Compliance is forwarded copies for all contracts over \$250,000.
- 4). Good internal controls and concepts of independence would allow the Office of EEO/Contract Compliance complete and unobstructed access to source documentation regarding awarded contracts.
- 5). Subcontractors are required to comply with KRS 45.560 to KRS 45.640 provisions. Good internal controls would require contractors verify in writing no subcontractors are employed.
- 6). If contractors are not fully apprised of consequences resulting from noncompliance with EEO contract provisions then they may be less forthright in their efforts to comply with laws and/or continue noncompliance.
- 7). Good internal controls and internal audit provisions dictate periodic verification of contractor claims by making periodic contract work site and/or contractor visits for suspected cases of noncompliance. Reliance on contractor claims of compliance, without occasional verification of audits when practicable, does not provide assurance contractors are correctly stating compliance efforts.



**COMMONWEALTH OF KENTUCKY  
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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
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**FINDING 99-FAC-11: The Finance And Administration Cabinet Should  
Improve Efforts In Effecting Equal Employment Opportunity Contract Compliance  
(Continued)**

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**Recommendation**

- 1). We recommend EEO contract folders include affidavits verifying contractors' efforts of compliance with percentage of employment requirements as is required by KRS 45.600 (6).
- 2). We recommend EEO contract compliance reports include complete names and address of employees and hire dates.
- 3). We recommend Contracting and Administration forward copies of Affidavits of Completion to the Office of EEO/Contract Compliance and that these affidavits be used for determining contract completion.
- 4). We recommend the Office of EEO/Contract Compliance have direct access to complete contract award information rather than rely on reports generated by Contracting and Administration.
- 5). We recommend the Office of EEO/Contract Compliance utilize a form letter requiring contractors to state "none" or "not applicable" for cases where subcontractors are not used.
- 6). We recommend all contractors subject to EEO compliance requirements be fully apprised of consequences for noncompliance. Further, we recommend the Office of EEO/Contract Compliance recognize continued instances of reported noncompliance as violations of the statutory requirements of KRS 45.560 to KRS 45.640 and take aggressive action to ensure contractors remain compliant throughout their contract period. Withholding payment to contractors in violation should be investigated and implemented if possible.
- 7). We encourage the Office of EEO/Contract Compliance to continue with its current plans for increased investigations of noncompliant or suspect contractors.

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
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**FINDING 99-FAC-11: The Finance And Administration Cabinet Should  
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(Continued)**

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**Management's Response And Corrective Action Plan**

*Weakness No. 1: The Office of EEO/Contract Compliance will require contractors with an underutilization of minorities to "certify by verified affidavit" that they have made reasonable effort to comply with percentage of employment requirements. The executive director will develop the affidavit for inclusion with the affirmative action plan request package. The cover letter that accompanies this package will state that the affidavit is required by statute and cite the reference. Projected Completion Date: March 15, 2000*

*Weakness No. 2: The Office of EEO/Contract Compliance will require contractors to provide a breakdown of the existing work force. The breakdown will include race, sex, age, position held, county and state of residence, and date of employment of each employee. The affirmative action compliance officer will develop the employment breakdown. This information will become Page 2 of Form CC-257. EEO/Contract Compliance will provide a copy of the revised form to the Division of Contracting and Administration for inclusion in bid packages/form of proposals. Projected Completion Date: March 15, 2000*

*Weakness No. 3: After meeting with an auditor on November 23, 1999, the Office of EEO/Contract Compliance began to obtain project completion information directly from the Division of Contracting and Administration. At present, the information is primarily verbal and there is no supporting documentation for the file. However, the affirmative action compliance officer does make a written notation about the information obtained from Contracting. Implemented: November 23, 1999*

*Note: The comments regarding weakness no. 3 pertain to general contracts. Information about completed subcontracts is obtained from the general contractor. Implemented December 1999.*

*Weakness No .4: The Office of EEO/Contract Compliance will continue to monitor the receipt of weekly Project Award sheets from the Division of Contracting.*

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
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**FINDING 99-FAC-11: The Finance And Administration Cabinet Should  
Improve Efforts In Effecting Equal Employment Opportunity Contract Compliance  
(Continued)**

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**Management's Response And Corrective Action Plan (Continued)**

*Weakness No. 5: The Office of EEO/Contract Compliance will require general contractors to indicate in writing whether the general contractor will award subcontracts of \$250,000 or more. Where no subcontracts are issued, the general contractor will state "none." Where subcontracts of \$250,000 or more are issued, the contractor will include company name, complete address, telephone number, and name of contact person. The affirmative action compliance officer will develop the subcontractor identification form. This information will become Page 3 of Form CC-257. EEO/Contract Compliance will provide a copy of the revised form to the Division of Contracting and Administration for inclusion in bid packages/form of proposals. Projected Completion Date: March 15, 2000*

*Weakness No. 6: (General Contractors): The Office of EEO/Contract Compliance checks noncompliant status monthly using its computerized contract monitoring system. Contractors that fail to comply with the Kentucky EEO Act receive a letter outlining the reason(s) for the determination of noncompliance. A copy of the letter is forwarded to the director of the Division of Contracting and Administration. Contractors that make no effort to comply with the provisions of the EEO Act after receiving the noncompliant status letter are identified in a memorandum that is sent to the director of the Division of Contracting and Administration. A copy of the memorandum is sent to the commissioner of the Department for Facilities Management and to the Finance and Administration Cabinet's general counsel. This procedure was implemented in early-1999.*

*In the case of companies that flagrantly ignore EEO reporting requirements, the Office of EEO/Contract Compliance will develop recommendations and discuss appropriate action with the general counsel and Department for Facilities Management/Division of Contracting and Administration. Projected Completion Date: February 29, 2000*

*Weakness No. 6 (Subcontractors): Subcontractors that fail to comply with the Kentucky EEO Act receive a letter outlining the reason(s) for the determination of noncompliance. A copy of the letter is forwarded to the general contractor. Contractors that make no effort to comply with provisions of the EEO Act after receiving the noncompliant status letter are identified in a follow-up letter that is*

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
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**FINDING 99-FAC-11: The Finance And Administration Cabinet Should  
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(Continued)**

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**Management's Response And Corrective Action Plan (Continued)**

*sent to the general contractor. A copy of the follow-up letter is sent to the Finance and Administration Cabinet's general counsel. This procedure was implemented in early-1999.*

*In the case of subcontractors that flagrantly ignore EEO reporting requirements, the Office of EEO/Contract Compliance will develop recommendations and discuss appropriate action with the general counsel. Projected Completion Date: February 29, 2000*

*Weakness No. 7: The Office of EEO/Contract Compliance will conduct site visits and records examinations of contractors that have a record of flagrant noncompliance. The executive director will work with the Office of Federal Contract Compliance Programs (Louisville division) in developing policies and procedures for conducting such visits and examinations. As the budget allows, EEO/CC may conduct visits to randomly selected contractors that do not have a history of noncompliance. Projected Completion Date: June 30, 2000*

**Auditor's Reply**

We recognize that FAC's Office of EEO/Contract Compliance has replied by stating forthright actions to bolster internal controls and compliance procedures. With respect to the weaknesses numbered 5 and 6, we recommend FAC document its proposed recommendations for dealing with flagrant noncompliance. We note that discussions with FAC staff throughout the audit indicated that no legal action or withholding of funds has historically occurred in cases of continued noncompliance.

With respect to weakness number 4 we recommend Contracting and Administration fully utilize computer resources and post the Project Award Sheets in electronic format. We recommend all concerned staff, including the Office of EEO/Contract Compliance, be given access to the data.

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-12: The Finance And Administration Cabinet Should  
Provide Sufficient Supporting Documentation For Capital Construction  
Expenditure Transactions**

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State Agency: Finance and Administration Cabinet

As part of our internal control compliance testing for Capital Construction projects, we examined 22 Capital (02 Fund) Expenditures over \$999,000. We tested to determine that backup documentation supplied by FAC's Accounts Pre-Audit Division reasonably supported the KAPS and Purchase Order explanations. Many of these items concerned House Bill (HB) 321 Surplus Budget Expenditures. We attempted to tie the appropriations to the FY 1998-2000 Surplus Budget presentation and tested for reasonable backup information and DOA Form/Purchase Order (PO) accuracy. Certain weaknesses concerning internal controls and policy and procedures were noted as follows:

- 1). Although we were able to verify amounts with the FY 1998-2000 Surplus Budget, the following Document Number items lacked substantive backup documentation (fully explaining the transaction) attached to the DOA form concerning HB 321 appropriations:

MA310139 – Breathitt County, \$1,500,000  
MA310021 – Whitley County, \$2,000,000  
MA310021 – Jefferson County, \$2,000,000  
DLGCS007 – Benham Inn, \$1,600,000

Also, the use of data field prefixes for Document Numbers appeared to be indiscriminate. We were unable to verify prefix assignments with Pre-Audit staff or otherwise obtain a comprehensive prefix listing from FAC's Accounts Pre-Audit Division.

- 2). The FY 1998-2000 Surplus Budget lists a Leslie County project for \$4,000,000 that appears to be the same as Document Number DLGCS025, which totals \$3,500,000. Backup documentation attached to the DOA Form was insufficient for the auditor to verify the difference. (Also see item 1 above concerning prefix use).
- 3). Due to insufficient backup documentation, we could not verify the following expenditures to HB 321 and HB 799-90 (Ford):

PO030272 – Jefferson County, \$1,057,345

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
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**FINDING 99-FAC-12: The Finance And Administration Cabinet Should  
Provide Sufficient Supporting Documentation For Capital Construction  
Expenditure Transactions (Continued)**

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PO349773 – Interstate Lodges, \$1,350,000  
PO076125 – Jefferson County / Ford (HB 799-90)  
MA020758 – Boyd County, \$1,500,000  
PO341693 – Kentucky Horse Park, \$1,500,000

- 4). All expenditure document PO forms (or facsimiles) were approved by FAC by use of the Division Director's rubber stamp.

Good internal control measures dictate expenditure documents are backed up with adequate source documentation that will allow the APA or other interested parties a means to verify expenditures. The following documents were used in our testing and provide a basis for the discussion below:

- 1998-2000 Budget of the Commonwealth
  - HB 321
  - KRS 45A.015(1) which states that the Uniform Commercial Code shall supplement the Kentucky Model Procurement Code
- 1). The backup documentation for HB 321 expenditures varied widely. These documents contained some form of backup information, but no substantive detail (such as abstracts from HB 321, or other information that would enable a FAC official, or agency representative to be fully aware of the nature of the transaction). Therefore, the APA, and others desiring to examine the expenditures, must look to other sources for full documentation. Large dollar expenditures denoted as "other" purchase types demand a full explanation both on the "description" section of the DOA Form and backup documents. Additionally, the APA, and other users of FAC financial information may, on occasion, utilize computer generated retrieval devices to pool fund transactions by Document Number rather than voucher number. The use of varied, and perhaps unknown, prefixes for HB 321 transaction Document Numbers is potentially problematic.
- 2). The effect of the difference is unknown. We note that additional backup documentation would possibly have explained the difference. Otherwise, there might be an error in the FY 1998-2000 Surplus Budget presentation.

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
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**FINDING 99-FAC-12: The Finance And Administration Cabinet Should  
Provide Sufficient Supporting Documentation For Capital Construction  
Expenditure Transactions (Continued)**

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- 3). These transactions are large in dollar amount and relatively few in number. Without sufficient backup information, we cannot verify the items' totals to the FY 1998-2000 Surplus Budget.
- 4). The signature stamp approval process is not verifiable in that stamps are easily transferred to unauthorized users and therefore subject to misuse. A rubber stamp is inappropriate for high-dollar amount transactions of this sort and susceptible to usurpation of approval. Additionally, the stamp may not be legally enforceable and/or in agreement with the Uniform Commercial Code.

**Recommendation**

All Items –

We recognize the implementation of MARS and the phase out of KAPS will provide for a different set of internal controls related to expenditures and Purchase Order procurement internal control procedures. The recommendations that follow should be incorporated, when possible, within the MARS system.

- 1). We recommend Pre-Audit provide complete backup documentation, allowing verification of purchase types denoted as "other" on the purchase orders (or similar reports). We recommend Pre-Audit standardize the prefix coding system for Document Type and limit data field entry to the standardized prefixes.
- 2). We recommend Pre-Audit verify the difference in this item which is stated as \$3,500,000 on the Purchase Order and appears to be stated as \$4,000,000 in the FY 1998-2000 Budget.
- 3). In the future, for special appropriations such as these, we recommend FAC provide a verifiable path from budget presentation to expenditure documents.
- 4). We recommend FAC discontinue use of signature stamps for expenditure document approvals, especially for large dollar amount items.

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
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**FINDING 99-FAC-12: The Finance And Administration Cabinet Should  
Provide Sufficient Supporting Documentation For Capital Construction  
Expenditure Transactions (Continued)**

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**Management's Response And Corrective Action Plan**

*The documentation requirements will be in the Pre-Audit Procedures for agencies and the "authorities" are assigned by the system. The budget is reconciled with the transactions loaded and all subsequent transactions are tied to said budget through document reference. The referenced budget item for \$4,000,000 can be accounted for by looking up the document number in STARS. There were two vouchers for DLGCS025 EO114955 and EO113138 totaling \$4,000,000 to Leslie Co. Signature stamps are no longer used with the exception of manual payroll transmittal and request for wire transfer. Procedures for the above will be documented with internal procedure.*

**Auditor's Reply**

Agency Comments concerning transaction documentation and authorized levels of approval are prospective in that they are specific to the MARS system which was not operating within the audit period. Further comment by the APA regarding these items is not warranted.

With respect to the \$4,000,000 transaction, our examination tested for agreement between the 1998-2000 Budget of the Commonwealth and the Purchase Order (or similar document) examined. The residual transaction referred to in the Management's Response and Corrective Action Plan was outside of the scope of this specific test in that it was less than \$1,000,000. We accept FAC's contention that it would be possible to undertake a search for the vouchers under STARS. Still, documentation concerning the appropriation and attached to the Purchase Order did not reveal that there were two vouchers that made up the \$4,000,000 expenditure. The special nature of the Surplus Budget expenditures, and the high dollar amount, demand that complete records be attached to the Purchase Orders. The description provided on the Purchase Orders was minimal for all of the HB 321 appropriations we examined.



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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-13: The Finance And Administration Cabinet Should  
Implement Policies And Procedures Relating To Small Or Small Minority Business  
Set-Aside Laws**

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State Agency: Finance and Administration Cabinet

Our examination of Capital Construction General Construction (Minor Object Code E703) Projects and Capital Fund (02) purchases revealed that there was no implementation of Kentucky Statutes and Administrative Regulations concerning small minority business set-asides during the FY 99 audit period. Thus, we were unable to test specific small or small minority business purchases and contract compliance attributes within the Capital Fund. FAC's EEO Contract and Compliance Director Yvette Smith and FAC Commissioner Don Speer corroborated our findings and agreed FAC did not implement any method which would enable designation of set-asides for Capital Construction purchases prior to notice for public bids as is contemplated by 200 KAR 5:076 and KRS 45A.675. Although FAC has recently contracted for a disparity study, we note that the set-aside provisions have been in effect, in relevant part, since 1990 and have, to our knowledge, never been substantively implemented.

Effective internal controls would ensure the Statutes and Regulations are implemented as contemplated by the Legislature. Without these controls, expenditures could be made for Capital Construction Fund goods and services that might otherwise be appropriately allocated to small minority businesses.

KRS 45A.675 states:

1. The cabinet shall designate as small or minority business set-aside state contracts of goods, equipment, construction, or services requested to be purchased by or for any agency whenever there is a reasonable expectation that bids can be obtained from at least three (3) small or minority businesses capable of furnishing the desired property or services at a fair and reasonable price. Such designation should be made prior to the public notice for bids, and the notice shall designate this invitation as a small minority business set-aside.
2. When an item has been designated as a small or minority business set-aside, invitations for bids shall be confined to small or small minority businesses and bids from other bidders may be rejected.
3. The cabinet shall award contracts to the responsible bidder whose bid meets specifications and offers the best value to the Commonwealth.

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-13: The Finance And Administration Cabinet Should  
Implement Policies And Procedures Relating To Small Or Small Minority Business  
Set-Aside Laws (Continued)**

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**Recommendation**

According to Commissioner Speer, FAC has decided not to implement small minority business set-asides based on *City of Richmond v. J.A. Croson Co.*, 488 U.S. 469 (1989) (USSC). Based on the court's decision in this case, FAC has recently contracted for a \$696,000 contract or "disparity study" in order to document any discrimination in the awarding of state contracts. FAC maintains that a study of this sort is necessary in order for the Commonwealth to actualize the laws. The regulation and the statutes were created after the court case. KRS 45A.675 was modified July 15, 1998. Based on this order of occurrence, it is difficult to pinpoint a causal relationship between the court's findings and FAC's decision not to implement the laws. Therefore, we request FAC fully document reasons why it has not applied these laws. If necessary, we recommend FAC request an opinion from the Kentucky Attorney General's Office concerning its decision not to implement the small or small minority business set-aside laws.

**Management's Response And Corrective Action Plan**

*With respect to the Nature of the Weakness or Noncompliance –*

*Reference is made in this area to my comments concerning the small and small minority business set aside program and that no such set asides were conducted during the FY 99 audit period for the Capital Construction General Construction Projects and Capital Fund area. My discussions with the auditor concerning the small and small minority business set aside program were related to procurements accomplished under the auspices of the Division of Material and Procurement Services in the Department for Administration and did not relate to capital construction projects. The Division of Material and Procurement Services only procures commodities and services unrelated to capital construction projects. Such procurements are accomplished under the Department of Facilities Management.*

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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
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**FINDING 99-FAC-13: The Finance And Administration Cabinet Should  
Implement Policies And Procedures Relating To Small Or Small Minority Business  
Set-Aside Laws (Continued)**

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**Management's Response And Corrective Action Plan (Continued)**

*With respect to the Recommendation for Improvement –*

*I disagree with the contention that since the Small and Minority Business Set Aside statutes were modified after the United States Supreme Court's findings in City of Richmond v. J.A. Croson, Co., that the Finance and Administration Cabinet is not compelled to comply with its[court's] findings. The Finance and Administration Cabinet believes that the Court's findings are applicable to Kentucky Statutes regardless of the statute's date of enactment. Moreover, the Finance and Administration Cabinet believes that continued implementation of those statutes could result in a legal challenge that the Commonwealth would be at risk to lose. Therefore, the Finance and Administration Cabinet requested that a Disparity Study be undertaken in order to meet the standards established by the United States Supreme Court.*

*Above response provided by Don Speer, Commissioner, Department for Administration.*

*Relative to your questions regarding the small/minority set-aside issues. Over the years we have tried to implement set-asides. Our efforts have not been successful for various reasons - lack of bidders in specific construction trade areas, no bidders in specific construction trade areas, inability to bond, etc. Eventually, we just stopped trying and turned our attention in other directions. For example, our effort now is concentrating on involving minority contractors with general contractors. In other words they become subcontractors to general contractors. So we are doing some things in this area, goal setting, etc.*

*Further, we believe the set-aside program puts us at legal risk which Mr. Speer has explained in his response above.*

*Additional response provided by Danny Shearer, Director, FAC Department of Facilities Management, Division of Contracting and Administration.*

**COMMONWEALTH OF KENTUCKY  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-13: The Finance And Administration Cabinet Should  
Implement Policies And Procedures Relating To Small Or Minority Business Set-  
Aside Laws (Continued)**

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**Auditor's Reply**

With respect to Mr. Speer's comments regarding the Nature of the Weakness or Noncompliance –

Construction set-aside of state contracts is provided in KRS 45A.675. Our examination included all Capital Fund expenditures. Our reference to Capital Construction General Construction Projects was merely ancillary to a particular area of testing where we discovered that the set-asides were not implemented. We were informed by various FAC staff that Commissioner Speer was the cabinet's authority on the set-aside issue. We recognize that the Department of Administration has separate concerns from the Department of Facilities Management. The fact remains that there are no set-asides for any area of expenditures within FAC, regardless of the department.

With respect to Mr. Speer's comments regarding the Recommendation for Improvement –

Modification of Small and Small Minority Business Set-Aside statutes occurred after the Supreme Court's findings and during a period in which the statutes were not being implemented. Commissioner Speer has suggested that this order of occurrence is our basis for giving deference to the statutes rather than the court case. Our comments concerned observance that certain laws were in effect yet not implemented for several years. KRS 45A.675 was modified after the court decision. Since FAC is the principal entity involved with implementing the set-asides, it would seem that it would have input into the change in legislation. We do not believe the best interests of the Commonwealth are served by creating and modifying set-aside laws if FAC has no intention to implement them.

Mr. Speer makes reference to "continued implementation" of the laws. Although our audit period and comments concern only the most recent fiscal year, it is likely that the set-aside laws have never been implemented to any substantive

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-13: The Finance And Administration Cabinet Should  
Implement Policies And Procedures Relating To Small Or Minority Business Set-  
Aside Laws (Continued)**

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**Auditor's Reply (Continued)**

measure. FAC sites the recently undertaken disparity study as a necessary measure for implementing set-aside laws. A question remains as to why FAC has taken so long to undertake the study and/or why these laws have been on the books for ten years without being implemented, abolished, or modified to a usable degree. Additionally, FAC has not offered any explanation of the possible "risk" involved with implementing the set-aside laws.

With respect to Mr. Shearer's comments –

Our findings concern minority and small business set-asides. Mr. Shearer has indicated that FAC has increased efforts in minority contracting activity and we have commented on this matter in our Record of Control Weakness. Mr. Shearer states that the laws put his office at "legal risk" but offers no explanation as to what the risk might be.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-14: The Division Of Contracting And Administration Should  
Maintain Timely Affidavits Of Completion**

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State Agency: Finance and Administration Cabinet

During our internal control testing related to General Construction Capital Construction Projects for fiscal year ended June 30, 1999, we examined 29 General Construction (E703) contracts. We noted specific internal control weaknesses concerning Affidavits of Completion related to two of the contracts:

- 1). PO-300735, Tuckpoint at Bluegrass Station
- 2). PO-413717, Central State Roof Repair:  
There was no Affidavit of Completion contained in the contract folder; however, the ledger tally indicated the contract was paid-in-full and complete.

Without verifiable and timely exercised Affidavits of Completion, Contracting and Administration cannot be assured contractors are not in agreement with the owner that they have been paid-in-full and satisfied all terms of the contract.

Official File Copy/Project Engineers General [Contract] Conditions, Part III, Article 19.3 – Final Completion of the Work, 3/1/95 revision, states in pertinent part that:

“...he [Architect] will so notify the Contractor in writing and promptly certify a final Certificate for Payment to the Owner.”

**Recommendation**

We recommend the Division of Contracting and Administration continue to administer the Affidavits of Completion on the standardized form and include the Affidavits in the contract file.

**Management’s Response and Corrective Action Plan**

*You indicate there was no Affidavit of Completion in the contract folders named above. The recommendation is that Affidavits of Completion using a standardized form always be in the contract file. We concur with your recommendation and will comply. This is our normal procedure, obviously this was over looked [sic] with these procurements.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-14: The Division Of Contracting And Administration Should  
Maintain Timely Affidavits Of Completion (Continued)**

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**Auditor's Reply**

We agree and appreciate FAC's efforts to increase compliance. We also note that other interested parties, such as FAC's Division of EEO Contract Compliance, should be provided with a copy of the Affidavit of Completion.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-15: The Division Of Contracting And Administration Should  
Improve Monitoring Of Compliance Regarding The Reporting Of Kentucky  
Revised Statute Violations**

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State Agency: Finance and Administration Cabinet

Contracting and Administration requires “Prime Bidders” on construction contracts to complete a form listing any “final determination(s) of violation(s) of KRS Chapters 136, 139, 141, 337, 338, 341, and 342 which have been rendered against the Prime Bidder/subcontractors within the five (5) years preceding the award of this [the] contract.” The statements are filed in the Official Bid Document(s). We chose to examine the contract files in order to determine if the forms were timely filed and complete as related to General Construction Capital Construction contracts for the fiscal year ended June 30, 1999. Additionally, we examined the forms and noted any violations of KRS Chapter 139 for the 29 contracts/contractors. None of the contractors revealed any violation of KRS Chapter 139. Our examination of KRS Chapter 139 violations revealed the following results:

The Revenue Cabinet was provided with the list of the 29 contractors and was able to verify (without naming specific violations or specific contractors) that “several [contractors] were issued tax bills for various reasons during the period [within 5 years] in question.”

Additionally, during our review of the 29 contracts/contractors, we noted one case of incomplete reporting:

1). PO-451027, ES-257-99, Carter Caves Cottages:

The Official Bid, “ES” folder contained a “Vendor Report of Prior Violations of KRS Chapters 136, 139, 141, 337, 338, 341 and 342” that was signed by the contractor yet was blank.

With respect to the reporting of violations, we believe Contracting and Administration has an implied duty to inform the responsible agencies of contractors’ statements. If the agencies are not able to inform Contracting and Administration of violations then the Commonwealth is not able to exercise the options available under the statute. Additionally, agencies may benefit from the statements. In the example tested (KRS Chapter 139), the Revenue Cabinet expressed interest in knowing names of contractors with state construction contracts. In its current form of implementation, KRS 45A.485 has little or no effect without a verification of contractors’ statements.



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-15: The Division Of Contracting And Administration Should  
Improve Monitoring Of Compliance Regarding The Reporting Of Kentucky  
Revised Statute Violations (Continued)**

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If Contracting and Administration accepts blank forms and does not enforce the provision, as stated on the form(s), “the Prime Bidder/Subcontractors shall write ‘None’ on the lines below,” they are not fully enforcing KRS 45A.485 and may be awarding bids to contractors without concern of violations.

KRS 45A.485 (1) (a) states, in pertinent part, that contractors shall:

[r]eveal any final determination of a violation by their respective company within the previous five (5) year period pursuant to KRS Chapters 136, 139, 141, 337, 338, 341, and 342 that apply to the contractor or subcontractor. . .

Additionally, contractors must be in continuous compliance with the provisions of the various KRS Chapters cited and violations shall be grounds under KRS 45A.485 (2) for:

- a) Cancellation of the contract; and
- b) Disqualification of the contractor from eligibility for future state contracts for a period of two (2) years.

**Recommendation**

We recommend Contracting and Administration forward reports of violations to agencies affected by KRS 45A.485 in order to verify the validity of contractors’ claims.

We recommend Contracting and Administration require the vendors’ reports of violations be completely filled out.

**Management’s Response and Corrective Action Plan**

*We recognize the importance of respondents completing the “Vendor Report of Prior Violations” form. Completing in terms of indicating “None” or listing violations and then a signature. We will be more dutiful in our monitoring of this area in the future. Additionally, when a respondent indicates violations, we discuss these with the respondent and the regulatory entity involved. Further, we will be connecting with the Revenue Cabinet, as well as other regulatory agencies to inform them of contract awards.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-15:** The Division Of Contracting And Administration Should Improve Monitoring Of Compliance Regarding The Reporting Of Kentucky Revised Statute Violations (Continued)

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**Auditor's Reply**

We acknowledge and appreciate FAC's effort to ensure contractors are providing accurate information. We further encourage FAC to supply a copy of the contractor's statement to any interested state agency and to apply the provisions of KRS 45A.485 (1) (a) when necessary.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-16: The Division Of Contracting And Administration Should  
Implement Procedures For All Applicable Sections Of The Kentucky Revised  
Statutes**

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State Agency: Finance and Administration Cabinet

We examined 29 General Construction (Minor Object Code E703) contracts during our internal control testing related to General Construction Capital Construction Projects for the fiscal year ended June 30, 1999. Sections within Kentucky laws, that were applicable to Contracting and Administration's oversight of Capital Construction projects, were considered during our examination. We noted two statutes that were not being implemented for any of the 29 items tested, and one statute that was not implemented for 28 of the 29 items. Additionally, two regulations were not implemented for any of the 29 items. The statutes and regulations, along with a brief description, follow:

1. KRS 56.778 concerns examination and consideration of life-cycle energy costs when awarding contracts. We could substantiate an effort to implement the statute for only one contract (PO-353044/ES-107-99) which concerned a chiller installation.
2. KRS 45A.520, KRS 54A.525, and 200 KAR 5:330 concerning utilization of materials with recycled materials content, were not implemented for any of the 29 contracts examined.
3. 200 KAR 5:325, which concerns giving consideration to Kentucky wood products producers when making purchases of building materials, was not enforced for any of the 29 contracts examined. We could not verify any process by which Contracting and Administration staff could assure that contract specifications did not preclude the use of Kentucky wood products. There was no method by which recommendation of Kentucky wood materials suppliers and/or subcontractors could be implemented in that we could not verify that any "list" of Kentucky manufacturers of wood products was provided to contractors.

These matters were discussed with Contracting and Administration staff and the Director in order to determine if the laws were implemented to any degree within the Division of Contracting and Administration. With the exception of KRS 56.778, which is considered only for chillers (and similar items) installed in state buildings, Contracting and Administration corroborated our assertion that implementation of these laws was not part of the internal control structure of the Contracting and Administration Division.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-16: The Division Of Contracting And Administration Should  
Implement Procedures For All Applicable Sections Of The Kentucky Revised  
Statutes (Continued)**

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Effective internal controls would ensure the statutes and regulations are implemented as contemplated by the Legislature. Without these controls, expenditures could be made for materials, such as wood and materials without recycled content, and that do not meet the standards as defined in the laws. In the case of failure to consider life-cycle energy costs, increased operating expenditures for the Commonwealth could occur.

With respect to the life-cycle energy use issue, KRS 56.778 states:

The Finance Cabinet shall require persons [contractors] submitting bids or plans for state-owned buildings to be constructed or substantially renovated after July 15, 1996, to include within those bids or plans life-cycle energy cost analyses. The cabinet shall consider those life-cycle cost analyses when evaluating competing bids or plans.

With respect to the recycled materials content issue, KRS 45A.520 states:

Every state agency shall when purchasing goods, supplies equipment, materials, and printing require a minimum recycled material content for those goods, supplies, equipment, materials, and printing.

Additionally, KRS 45A.525 states that FAC shall require:

[E]very person [contractor] entering into a contract with a state agency for building, altering, repairing, improving, or demolishing any public structures or buildings or other improvements to any public real property to use goods, supplies, equipment, materials, and printing necessary to fulfill the contract which meet the requirements for recycled material content as adopted pursuant to KRS 45A.520.

200 KAR 5:330 Section 3, further defines KRS 45A.520 and KRS 45A.525 and lists, in Section 3, materials such as cement, various steel materials, and raw materials commonly used in building construction and lists recovered and/or recycled materials contents for the materials.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-16: The Division Of Contracting And Administration Should  
Implement Procedures For All Applicable Sections Of The Kentucky Revised  
Statutes (Continued)**

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With respect to the Kentucky wood products issue –

200 KAR 5:325 requires the FAC develop a list of Kentucky manufacturers that produce wood products including construction materials, furniture, and other items that might be purchased under the 02 Capital Expenditure Fund.

**Recommendation**

We recommend the Division of Contracting and Administration include life-cycle energy costs analyses when awarding contracts for building construction and renovation and not limit application of the law to chiller contracts.

We recommend the Division of Contracting and Administration employ a method to distribute Kentucky's recycled materials content requirements to contractors and monitor contractors materials purchases, to the extent practicable, to assure that buildings constructed and renovated include recycled materials as required by the law.

We recommend the Division of Contracting and Administration employ a method to identify Kentucky-made wood products and distribute lists to contractors for consideration in construction materials purchases.

**Management's Response And Corrective Action Plan**

*In general, the Department's approach to energy efficiency is to pick the most energy efficient systems during the design process and develop specifications to achieve the highest efficiency in available equipment/materials. There are exceptions, chillers for example, that given the intense energy usage, refrigeration issues, other variables-life cycle costing becomes applicable. We have accomplished a number of chiller life-cycle procurements over recent years.*

*Given your comments on the use of recycled materials and Kentucky Wood products, obviously assimilation of materials/equipment for construction projects is a very involved, complex exercise. Also remember, we are attempting to stay within define budgets. To this point, we have not discovered a logical approach to either, does the Auditor have recommendation.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-16: The Division Of Contracting And Administration Should  
Implement Procedures For All Applicable Sections Of The Kentucky Revised  
Statutes (Continued)**

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**Auditor's Reply**

With respect to the life-cycle energy cost issue, we could not locate any presentation of life cycle energy costs analysis within the contract folders examined except for one contract concerning a chiller project. As written, the law appears to have blanket coverage for all general construction projects undertaken by the state. We recommend FAC define parameters for inclusion of life cycle energy costs analyses in the bid process and require contractors to submit such information when practicable.

With respect to the recycled materials issue, we recommend FAC apprise contractors of requirements as provided in the law by including applicable items within the standard bid packages.

The Kentucky Wood Products Competitive Corporation (KWPPCC) was created and established under KRS Chapter 154 as a de jure municipal corporation and political subdivision of Kentucky. You have requested that we recommend a method of satisfying the applicable Kentucky Wood Products law. In response, we recommend FAC consult with KWPPCC concerning ways to make contractors aware of the availability of Kentucky wood products. An information package is available from KWPPCC and provides a comprehensive list of Kentucky wood products suppliers. This, or a similar package, could be made available to bidding contractors and would seemingly fulfill the intent of the law.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-17: The Finance And Administration Cabinet Should  
Provide Clear Language Regarding Enterprise Zones And Use Tax Exemptions  
Where Applicable**

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State Agency: Finance and Administration Cabinet

We examined 29 General Construction (Minor Object Code E703) contracts during our internal control testing related to General Construction Capital Construction Projects for the fiscal year ended June 30, 1999. Standardized terms and conditions were provided to each of the 29 contracts/contractors awarded bids. Within the General Conditions of the Official Bid Documents, certain Articles (numbers vary) concern Kentucky sales and use taxes. Bidders are not informed of KRS Chapter 154 Enterprise Zone sales and use tax exemptions when certain exemptions are available by virtue of the construction project's location within a certified Enterprise Zone. Of the 29 contracts we examined, one job was located in an Enterprise Zone: PO-316414, ES-19-99, Northern Kentucky Convention Center.

The General Contractor for the Northern Kentucky Convention Center sent a letter to the oversight entity (Architecture and Engineering Firm) and questioned "[w]hich tax is applicable for this project, sales or use tax." In turn, the oversight entity forwarded the contractor's letter to Contracting and Administration for clarification. We could locate no record of reply concerning the availability of KRS Chapter 154 exemptions and there was no mention of Enterprise Zone exemptions in the Terms and Conditions of the Official Bid.

Contractors estimate costs when bidding with the Commonwealth. The Enterprise Zones are located in three of Kentucky's most active construction locations: Louisville, Lexington, and Northern Kentucky. If contractors are fully aware of tax exemptions available under KRS Chapter 154, they will be able to consider the lower costs when offering bids for Enterprise Zone contracts.

KRS 154.45-090 describes tax advantages, credits, and exemptions for qualified businesses.

**Recommendation**

We recommend Contracting and Administration consult the Economic Development Cabinet and the Kentucky Revenue Cabinet in order to assure that contractors bidding on Enterprise Zone jobs are properly informed of tax advantages available under KRS Chapter 154.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-17: The Finance And Administration Cabinet Should  
Provide Clear Language Regarding Enterprise Zones And Use Tax Exemptions  
Where Applicable (Continued)**

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**Management's Response And Corrective Action Plan**

*Your Audit spoke to the Northern Kentucky Convention Center project and it's [sic] location in an Enterprise Zone. Locations in an Enterprise Zone results in a sales/use tax exemption. The fact this project is located in an Enterprise Zone and resulting exemption from sales/use tax was made known in the bid documents to potential bidders. See the attached documentation. We attempt to stay abreast of the situations you describe and communicate such to our bidders. [A copy of the "Project Engineers Official Contract Book" was provided in pertinent part.]*

**Auditor's Reply**

We note the Project Engineers Official Contract Book contains the notation "[t]he project is located in an Enterprise Zone, resulting in sales tax exemption for the Project." The Project Engineers Official Contract Book was not available at the time of audit. We did not note any language concerning the issue in the "ES" contract folder; if such information is contained in this folder, we overlooked it. While we believe FAC's statement is a step in the right direction, the statement provided falls short of fully apprising the contractors of their rights and responsibilities regarding sales and use tax liabilities. KRS Chapter 154 is complex and problematic from a sales and use tax perspective. Although certain exemptions are provided for sales and use tax, there is no blanket exemption as is stated. We recommend FAC consult with the Kentucky Revenue Cabinet's Division of Law and the Economic Development Cabinet for further qualification as to the appropriate sections of KRS Chapter 154. The documentation referenced in the Management's Response and Corrective Action Plan is unique to the Northern Kentucky Convention Center Project. Other contracts tested were possibly within Kentucky Enterprise Zones. Our testing did not include identification of geographical boundaries.



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-18: The Division Of Contracting And Administration Should  
Improve Policies Concerning Insurance Coverage For Construction Contracts**

State Agency: Finance and Administration Cabinet

During our internal control testing related to General Construction Capital Construction Projects for the fiscal year ended June 30, 1999, we examined 29 General Construction (Minor Object Code E703) contracts. We noted specific internal control weaknesses concerning insurance policies related to two of the contracts:

1). PO-289302, Hunts Hardwood Mill Site Soil Reclamation:

The insurance policy located in the contract file was expired for an open job. The policy expired November 1, 1998, and no extension could be located by Contracting and Administration staff. The contract was extant through the end of the audit period.

2). PO-392642, New Covered Horse Ring:

The insurance policy located in the contract file was expired for an open job. The extended policy expired March 3, 1999, and no further extension could be located by Contracting and Administration staff. The contract was extant through the end of the audit period.

When adequate insurance is not required and documented, the Commonwealth could incur unnecessary costs and imperilment. Inadequate procedures for documenting insurance policies, such as reliance on the insurance provider to periodically provide the owner with updated policy information, is of little value if the updates are not received in a timely manner. Without verifiable insurance policy information, Contracting and Administration cannot be assured contractors are adequately insured through completion.

Official File Copy/Project Engineers General [Contract] Conditions, March 1, 1995 revision (representative example), states in pertinent part that:

The Contractor shall furnish the Owner with satisfactory evidence that he has secured and is maintaining the required insurance coverage.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-18: The Division Of Contracting And Administration Should  
Improve Policies Concerning Insurance Coverage For Construction Contracts**

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**Recommendation**

We recommend Contracting and Administration implement internal control policies and procedures to ensure that contractors timely submit insurance policies and extensions and that a contractor not be relieved of its insurance obligation until an Affidavit of Completion is executed. We recommend that the Certificates of Insurance be filed in the contract folders.

**Management's Response and Corrective Action Plan**

*PO-289302, Hunts Hardwood Mill Site Soil Reclamation*

*PO-392642, New Covered Horse Ring*

*You have raised a concern relative to insurance extensions. Your point is legitimate. There are projects that are active beyond the original insurance coverage, which, at the beginning of the project, had defined substantial and final completion dates. We need to work toward defining a solution to address this concern and will over the next several weeks.*

**Auditor's Reply**

We recommend Contracting and Administration maintain electronic files with each contract's insurance expiration date and that they strengthen controls to ensure insurance is maintained until contracts are officially closed by an Affidavit of Completion. This might be facilitated by generating form letter requests for updated insurance evidence prior to policy expiration.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-19: The Finance And Administration Cabinet Should  
Improve Monitoring For Duplicate Payments**

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State Agency: Finance and Administration Cabinet

As part of our FAC Capital Projects internal controls testing, we identified 48 potential duplicate purchases (same amount and same day). The Pre-Audit division pulled backup information for the purchase orders in question and we were able to reconcile all but two of the items. The two possible duplicate purchase payments are as follows:

- 1) PO61137/E0115159 as a possible duplicate of PO61137/E0115300, Culligan Water –  
This purchase of \$193 appears to have been paid twice. Pre-Audit staff was unable to provide an alternative explanation.
- 2). PO419002/EVW00322 was presented twice on STARS. The backup invoice from the vendor (Wilson Roofing) states an invoice total of \$1,054 and appears to have been paid twice based on the Purchase Order total of \$2,108. Pre-Audit Staff was unable to provide an alternative explanation.

According to Pre-Audit staff, there was no automated system in place to identify potential duplicate Purchase Orders and/or duplicate amounts within any of the Fund types.

The Commonwealth may have paid for the same goods and/or service twice. There may be internal control weaknesses within the purchase process in that there is no automated method of identifying potential duplicates for further review. Additionally, the use of the same Purchase Order for duplicate purchases is potentially confusing and may lead to duplicate payments.

Good internal control practice and information technology oversight would provide for an automated method of identifying potential duplicate purchases.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-19: The Finance And Administration Cabinet Should  
Improve Monitoring For Duplicate Payments (Continued)**

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**Recommendation**

We recommend FAC implement an automated process to identify potential duplicate purchases within the framework of the MARS system. Any suspected duplicate purchases should be investigated. We recommend FAC not allow the use of the same Purchase Order number to prevent duplicate purchases.

The two items listed above should be identified to the respective agencies for further investigation and recovery.

**Management's Response And Corrective Action Plan**

*MARS document numbering is unique within FY, FQ, FM, document type, agency, document number. Example: Acct period 00308 PV 758 P1000000001. See the Document Control Table DCTL*

*There is an overridable edit when processing a payment that is a duplicate invoice number. The key to the invoice is vendor number and 12 digit invoice number. See Open Vendor Invoice Header OVIH.*

*Duplicate invoice check is part of the Agency Pre-Audit Procedures. We will contact the above agencies to recoup potential duplicate expenditures.*

**Auditor's Reply**

The agency's response concerns the MARS system. MARS was not utilized within the audit period. We appreciate efforts to recover potential duplicate expenditures. The duplicate invoice check referred to in FAC's response, unless done visually, is unknown to us. We noted no automated system in place within the audit period. We encourage FAC to examine the MARS system and fully utilize and/or modify its capability to identify potential duplicate payments such that loss is minimal.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-20: The Finance And Administration Cabinet Should  
Improve Monitoring For Split Purchase Arrangements**

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State Agency: Finance and Administration Cabinet

As part of our examination of FAC Capital (02 Fund) internal controls testing, we identified 76 potential (grouped) transactions as split purchases. A split purchase, for purposes of our testing, was identified as a group (greater than one) of purchases with date of occurrence structured to circumvent agency limits, quotation requirements, or competitive bid requirements. Testing was limited to 02 Fund purchases made on the same day from the same vendor.

We utilized the delegated purchase limit authority of the particular agency transaction tested as a parameter in order to determine if the purchases had been constructed in such a way to avoid agency limits, quotation requirements, or competitive bid requirements. Of those items we selected, four purchase groupings were identified as potential split purchases. The questionable purchase groupings, representing transactions made on the same day, are as follows:

- |     |                    |          |
|-----|--------------------|----------|
| 1). | PO064893/EO111785  | \$ 9,765 |
|     | PO0282949/E0111786 | 6,200    |
|     | PO282950/E0111787  | 1,350    |

Collectively these transactions exceed the agency limit (\$7,500) for obtaining three quotations as required per FAC policy BO-220-10 and 111-55-00.

- |     |                   |        |
|-----|-------------------|--------|
| 2). | PO371623/EV003910 | \$ 728 |
|     | PO371788/EV003924 | 641    |
|     | PO371842/EV003926 | 2,127  |
|     | PO415544/EV003911 | 317    |
|     | PO390284/EV003893 | 6,210  |

Collectively, these purchases exceed the agency limit (\$7,500) for obtaining three quotations as required per FAC policy BO-220-10 and 111-55-00.

- |     |                   |          |
|-----|-------------------|----------|
| 3). | PO339409/EV001058 | \$16,570 |
|     | PO339419/EV001059 | 4,000    |

Collectively, these purchases exceed the agency's delegated purchase limit (\$10,000).

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-20: The Finance And Administration Cabinet Should  
Improve Monitoring For Split Purchase Arrangements (Continued)**

- 4). PO419085/EV004205   \$3,150  
PO437709/EV004260    4,850

Collectively, these purchases exceed the agency limit (\$7,500) for obtaining three quotations as required per FAC policy BO-220-10 and 111-55-00.

- 5). PO379285/EV002095   \$16,253  
PO379305/EV002096    11,272

Collectively, these purchases exceed the agency's delegated purchase limit (\$15,000)

Additionally, our testing included Cabinet 35, Transportation Cabinet purchases. The items tested are as follows:

PO302458/EVW00003	PO420823/EVW00329
PO305489/EVW00003	PO420827/EVW00330
PO305504/EVW00002	PO420832/EVW00327
PO305501/EVW00005	PO420838/EVW00328
PO305505/EVW00006	PO420838/EVW00326
PO309317/EVW00007	PO309323/EVW00008

It came to our attention that these transactions included Transportation Cabinet classifications of "repair" expenditures made under the 02 Fund that might have been best classified as maintenance items. Conversations with GOPM and Transportation Cabinet officials revealed that there are no policy and procedure guidelines or other parameters that provide any definition or clarification of "repair" and "maintenance" classifications. Additionally, GOPM and Transportation Cabinet officials indicated classifications are essentially at the whim of the individual(s) making the appropriation and "routine maintenance" is likely, if not often, included in Capital Construction (02 Fund) transactions.

The sample selection included purchases made from Jack Mann Scales for highway weigh station work. The expenditure source documents (invoices) contain a variety of descriptions for activities. Without further definition of the "repair" designation, we were unable to determine if the transactions should have been classified as "maintenance" items.

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-20: The Finance And Administration Cabinet Should  
Improve Monitoring For Split Purchase Arrangements (Continued)**

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With respect to the delegated purchase authority limits and quotation requirement issues, without proper internal controls, FAC cannot be assured agencies are within purchasing limits. Agencies may be structuring purchases to circumvent purchase limitations.

With respect to the Transportation Cabinet issue – FAC cannot be assured financial statements are presented in a manner consistent with KRS 45A.030 which excludes routine maintenance of existing structures, buildings, or real property within the definition of “construction.” We note that the Transportation Cabinet purchases identified above were classified as E703 General Construction Account Numbers. Government Accounting Standards Board (GASB) defines the “capital projects funds” as including acquisition or construction of major capital facilities. Routine maintenance does not seem to be within this classification.

We considered the following criteria in making our findings:

- FAC Policies and Procedures: BO-220-10 and BO-111-55
- GASB 1300.104 a. (3) Capital Projects Fund
- KRS 45A.030 (4) which defines “construction” as follows:

‘Construction’ means the process of building, altering, repairing, Improving, or demolishing any public structures or buildings, or other public improvements of any kind to any public real property. It does not include the routine maintenance of existing structures, buildings, or real property.

**Recommendation**

We recommend FAC implement a policy for an automated method of identifying potential split purchases. Additionally, we recommend FAC enforce the FAC Policy and Procedures Manual sections related to Capital expenditures quotation requirements and purchase authority delegations.

With respect to the Transportation Cabinet issue, we recommend FAC consult with Bill Hintze, Deputy Director of GOPM, and Glenn Mitchell, Executive Director of Policy and Budget. We have discussed the classification issues cited above with Mr. Hintze and Mr. Mitchell. They indicated the issue had been

**COMMONWEALTH OF KENTUCKY  
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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-20: The Finance And Administration Cabinet Should  
Improve Monitoring For Split Purchase Arrangements (Continued)**

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**Recommendation (Continued)**

discussed internally on prior occasion(s) and that guidance and/or clarification of “repair” and “maintenance” classifications within the Transportation Cabinet might be warranted. Additionally, Mr. Mitchell indicated the Transportation Cabinet does not fully utilize maintenance funds for 02 fund maintenance expenditures and repair expenditures are likely pooled into the 02 Capital Projects Fund. Without further clarification of the classifications, the Commonwealth may be categorizing Transportation expenditures into the 02 fund that should be within other classifications.

**Management’s Response And Corrective Action Plan**

*I would defer to Division of Material & Procurement Services regarding the system functionality surrounding split purchases, quotation requirements, and authority assignments. As for the transportation classification issue, we can provide guidance with regard to the use of the funds and object codes, but we don’t have much to offer the conversation regarding what technically is considered maintenance vs. repair in individual situations in light of budgetary intentions. We will request such guidance of GOPM and incorporate it where appropriate.*

**Auditor’s Reply**

With respect to the Transportation Cabinet classification issue, we will refer the comment to Bill Hintze and Glenn Mitchell for further response. System functionality for STARS-based split expenditures examination is noted herein. MARS will be tested in future audits.



**COMMONWEALTH OF KENTUCKY  
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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-21: The Governor’s Office For Technology Should Improve  
Internal Controls For Ensuring Adequate Documentation To Support Agency  
Transactions**

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State Agency: Finance and Administration Cabinet

During our review of the Governor’s Office for Technology (GOT-formerly Department for Information Systems) receipts, we selected a random sample of 50 receipts for testing to determine if receipts were recorded correctly. We looked at receipts that were posted in June 1999 (FY 99) and July 2000 (FY00) to perform this test. The telecommunication receipts had no supporting documentation for fiscal year 2000. These receipts were processed under MARS, and we were unable to trace from the billing to MARS. The telecommunications billing is done by a data set, and each month the data is erased to enter the new billing information. The hard copies of the bills from the phone companies are thrown away. There was proof that the receipt comes out of the agency and into the GOT account but there is no way to trace this amount to see what service it was for. Data set billing makes it impossible to track one specific amount. The exceptions noted were:

- (14) Telecommunication receipts had no supporting documentation.

This supporting documentation could not be tested to ensure GOT is adequately recording receipts.

In order to maintain strong internal control, documentation should be maintained to provide backup for the receipts.

**Recommendation**

We recommend GOT develop policies and procedures for maintaining adequate supporting documentation for receipts. There must be some support for the receipt to prove its existence and valuation.

**Management’s Response and Corrective Action Plan**

*The statement “The telecommunications receipts had no supporting documentation FY 2000” is correct. The audit period is July 1, 1998 through June 30, 1999. Due to new MARS billing restructure, telecommunications data base billing did not correspond with MARS transaction IDs for the month of July,*

**COMMONWEALTH OF KENTUCKY  
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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-FAC-21: The Governor's Office For Technology Should Improve  
Internal Controls For Ensuring Adequate Documentation To Support Agency  
Transactions (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*1999 or for the first month of FY-2000. The Data Set used for the billing purposes was erased during the preparation of August, 1999 billing. Procedures were implemented in August, 1999 to save the Data Set for historical purposes and to ensure receipts provided supporting documentation for FY 2000.*

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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-GOT-22: The Governor’s Office For Technology Should Restrict  
Programmer Access To Production Libraries**

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State Agency: Finance and Administration Cabinet

Governor’s Office of Technology (GOT) (formerly Department of Information Systems) programmers are being given alter and update access to agency production libraries and data. Programmers do not require this type of access in order to perform their job functions. Agency security contacts are inappropriately giving GOT programmers access to their production libraries and data. There is an increased risk unauthorized changes may be made to production data or programs.

**Recommendation**

In order to mitigate the risk to GOT, we recommend a policy be created and enforced that disallows programmers from being given access to any agency’s production environments. This policy should be communicated to all agency security contacts and monitored by GOT in order to ensure the policy is being followed.

**Management’s Response and Corrective Action Plan**

*There are circumstances noted below that generally require the Governor’s Office of Technology (GOT) programmers to have access, for a limited time, to agency production libraries and data – (1) data cleanup is a routine part of programmer’s responsibility. GOT gets requests from customers to clean up production records due to various problems created in production code. These changes are performed within the procedures developed with the agency, and (2) many times problems cannot be duplicated in the development or test environment and a copy of a production case may be used for testing to duplicate the specific circumstance. In these situations, production data is accessed and used for testing.*

*GOT’s Recommendation:*

*Develop/publish policy that authorizes agency security officers to give GOT access to their production libraries/data for finite periods of time to address production and testing problems. Agency officers would provide authorization for a limited period of time only after receiving appropriate documentation (reason, signature, length of time). GOT management staff will periodically review documentation and determine whether the authorization continues to be valid.*

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CHS-23: The Year-End Cash Balance For The County Health  
Central Bank Account Should Be Reported**

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State Agency: Cabinet for Health Services

During our review of CHS year-end closing package, we noted that the Department for Public Health did not report the account balance of the County Health Central Bank Account (CHCBA) on the Annual Financial Report Cash Worksheet (AFR 10) form. The balance in the CHCBA at June 30, 1999 was \$8,225,754 and includes general fund, agency revenue fund, and Federal fund money.

In addition to the cash balance in the CHCBA, the Resource Management Branch did not report the interest receivable of \$1,168 earned from the repurchase agreement's overnight sweep of the account on June 30, 1999.

Not reporting these balances at year-end understates the assets of cash and accounts receivable on the financial statements.

CHS should report the cash balance and interest receivable from this checking account to FAC's reporting team so that it can be included on the Commonwealth's financial statements. An adjustment was made during the audit to record the cash balance in the financial statements.

**Recommendation**

We recommend that both the cash balance and the interest receivable at June 30, 1999 be reported on an AFR 10, closing package form. A copy of the form should be sent to the FAC reporting team and a copy to the Auditor's Office. These amounts should be reported on the agency's closing package in future years.

**Management's Response and Corrective Action Plan**

*Cabinet for Health Services has worked with the APA and Controllers office to resolve this issue. The cash and receivable balances are being included in the CAFR report.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CHS-24: The Office Of The General Counsel Should Improve  
Controls Over Contingent Liabilities**

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State Agency: Cabinet for Health Services

The Office of the General Counsel completed and issued the 1999 Contingent Liabilities Status Report on September 30, 1999. The Report contained errors in the department compilations. The department's collective ending balances for contingent liabilities of \$1,701,812 were overstated by \$1,101,812. This was primarily due to the inclusion of prior year paid cases.

In addition, cases that had a risk for payment of less than 75% were included in the closing package for contingent liabilities. FAC instructions require only those cases that are 75% or above to be included in the closing package.

The overstatement of contingent liabilities increases the amount of financial risk the state apparently incurred, as of June 30, 1999, but in reality does not owe. An adjustment was made to report the correct amount of contingent liabilities.

The Office of the General Counsel was provided with a set of FAC instructions for the completion of the closing package.

**Recommendation**

We recommend the Office of the General Counsel prepare the Contingent Liabilities Status Report from a schedule of current cases and not what was included on prior year reports. We also recommend the status report contain only those cases assessed as having a 75% or greater chance of being paid by the state within one year.

**Management's Response and Corrective Action Plan**

*We quite agree with the recommendation for improvement. The overstatements in the past were attributable to "bundle" of cases handled by counsel/staff no longer with the Cabinet.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CHS-25: The Department Of Medicaid Services Should Improve  
Control Procedures Over The Medical Assistance Program**

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State Agency: Cabinet for Health Services

UNISYS (the corporation under contract with the Cabinet for Health Services to process Medicaid Claims) adjudicates claims for the Medicaid Expenditures. During our audit period, the Department of Medicaid Services (DMS) performed a “voluntary” Claims Processing and Assessment System (CPAS) to ensure proper claims processing. DMS’s sample selection method used a starting number, with fixed intervals to select the samples within each of the categories (e.g. “Hospital Services,” “Long-Term Care Services,” etc.). For “Hospital Services” and “Individual Practices, Clinics, Services & Supplies,” there was not a fixed interval. This was due to a lack of claims within certain time periods to have a fixed interval. The total claims selected for testing was far below the final number of the claim universe. This selection method resulted in approximately 15% of the population having no opportunity of being selected. Additionally, UNISYS selected the sample of claims to test. DMS did not perform a reconciliation of the population to ensure the sample was pulled from the entire population of adjudicated claims.

Although CPAS is no longer required by the Health Care Financing Administration (HCFA), DMS has elected to use CPAS as a control system. Therefore, management is responsible for ensuring the controls are in place and operating effectively. This finding was noted in prior years as an “Other Matter.” We have up graded this finding to a “reportable condition” for FY 99.

The claims from which the CPAS samples are selected are entered by “Recipient Numbered Order” when read into the system. Accordingly, with the limited interval sample selection method used, the higher numbered recipients do not have an equal chance of being selected. Approximately 15% of the claims had no chance of being selected or reviewed.

Because UNISYS pulls the sample and no reconciliation is performed by DMS, the sample could be manipulated to omit or withhold problem areas within the system from DMS’s knowledge. This could adversely affect the results of the CPAS testing.

Good internal controls dictate that information received from outside sources be verified for completeness and accuracy. In addition, Part II of the State Medicaid Manual, Chapter 6 states, “the sample selection must be performed on a complete sampling frame. A sampling frame for the prescribed sample universe is all Medicaid line items authorized for payment.”

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CHS-25: The Department Of Medicaid Services Should Improve  
Control Procedures Over The Medical Assistance Program (Continued)**

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**Recommendation**

We recommend DMS revise their sample selection method for CPAS testing to include the complete sampling frame. We also recommend DMS establish reconciliation procedures to ensure the sample selected is representative of the entire population/universe. Alternately, DMS might consider pulling the sample from the universe of actual claims paid through STARS.

**Management's Response and Corrective Action Plan**

- *Effective July 1, 1999 the stratum will be changed monthly to ensure that the sample selected is representative of the entire population/universe.*
- *Control totals are in the process of being implemented to ensure all claims are included in the universe.*
- *STARS does not carry claim information, therefore DMS cannot be pulled from this database.*

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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CHS-26: The Department Of Medicaid Services Should  
Strengthen Controls Over The Kentucky Health Care Program**

State Agency: Cabinet for Health Services

During our review of internal controls over Medicaid Expenditures, we examined forty disproportionate share payments (DSH) made under the Kentucky Health Care Program (KHCP). In doing so, we obtained purchase orders and supporting information documenting payments made during FY 99.

Our testing indicated the following:

- Seven payments could not be tested because payment calculation was inconsistent with other DSH payment calculations. For example, Inpatient/Outpatient days were dollar amounts instead of number of days, the conversion factor was not stated, and the payment rate was a percent instead of a dollar amount.
- There was an exception noted for all payments because of lack of supporting documentation (i.e., conversion factor spreadsheet). This document could not be obtained from the agency; therefore, a comparison could not be made between the spreadsheet and the conversion factor per KHCP payment computation spreadsheet.
- There were seven exceptions noted where the per diem rates did not agree to the Kentucky Medical Assistance Program Inpatient Rate Notice from DMS.

Without supporting documentation and consistency, the audit trail for the DSH payments is diminished. Therefore, the data used in calculating the payment cannot be verified. In addition, if the per diem rates used for the payment calculation do not agree to the Rate Notice from DMS, incorrect DSH payments could be made.

Good internal controls dictate supporting documentation be maintained and verified for completeness and accuracy. In order to comply with sound accounting practices, procedures must be consistent.

Furthermore, the lack of supporting documentation part of this finding is a repeat from the FY 98 Agency Level Report, where the finding was classified as an “other matter.” The corrective actions described by the agency in response to prior year finding have not been fully implemented. After considering all of the issues above, we have decided this finding is a “reportable condition” for FY 99.



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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CHS-26: The Department Of Medicaid Services Should  
Strengthen Controls Over The Kentucky Health Care Program (Continued)**

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**Recommendation**

We recommend that:

- Payment calculation procedures be consistent. Therefore, all information used to calculate the payment should be shown on the reconciliation page.
- The agency maintain documentation to support disproportionate share payments made under KHCP.
- The agency take extra precautions when computing disproportionate share payments to ensure the correct rates are used.

**Management's Response and Corrective Action Plan**

- *Seven payments could not be tested because payment calculation was inconsistent with other DSH payment calculation. For example, Inpatient/Outpatient days were dollar amounts instead of number of days, the conversion factor was not stated, and the payment rate was a percent instead of a dollar amount.*

*As explained during audit testing, payments to hospitals differ, depending on each hospital's number of licensed acute care beds. Payments to hospitals with 200 or more licensed acute care beds are based on their per diem rate. Payments to hospitals with fewer than 200 licensed acute care beds are based on their cost-to-charge ratio (a percentage) applied to all charges. The conversion factor is incorporated in the KHCP payment computation spreadsheet and is based on an ad hoc report obtained from our fiscal agent.*

- *There was an exception noted for all payments because of lack of supporting documentation (i.e., conversion factor spreadsheet). This document could not be obtained from the agency, therefore a comparison could not be made between the spreadsheet and the conversion factor per KHCP payment computation spreadsheet.*

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CHS-26: The Department Of Medicaid Services Should  
Strengthen Controls Over The Kentucky Health Care Program (Continued)**

**Management's Response and Corrective Action Plan (Continued)**

*A conversion factor spreadsheet does not exist. As noted above, the conversion factor is based on an ad hoc report obtained from DMS' fiscal agent and provided on a diskette by another Medicaid division. The conversion factor was then input into the KHCP payment computation spreadsheet. For SFY 2001 and thereafter, the Division of Financial Systems will have control over the entire process, from obtaining the ad hoc report to posting the conversion factor to the KHCP payment computation spreadsheet. A conversion factor spreadsheet will not be created. However, the ad hoc report will be available for review by the auditors.*

- *There were seven exceptions noted where the per diem rates did not agree to the Kentucky Medical Assistance Program Inpatient Rate Notice from DMS.*

*DSH payments are made based on the rate in effect for the period DSH payments are made, which is based on the most recent audited cost report. The Kentucky Medical Assistance Program Inpatient Rate Notice from DMS can be distributed after the period in which the DSH payments have been made, depending on when the audited cost reports are received. The per diem rates paid did not agree with the rate notice because the rate notice was generated after the payments were made. Because DSH is a linseed pool of money, retroactive adjustments are not normally made when the rate changes. The new rate is used to determine future DSH payments.*

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CHS/CDP-27: Custom Data Processing Inc. Should Require  
Formal Requests For All Program Changes**

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State Agency: Cabinet for Health Services

Formal request forms are not required to be completed and approved for all types of change requests. Documentation and approval of change requests helps to ensure only authorized changes are made by programmers. Custom Data Processing, (CDP) Inc. does not require all changes to be documented on the request form. Several types of changes are accepted via telephone, without written or documented approval. Unauthorized changes may be made to production data or programs.

**Recommendation**

We recommend that all change requests be documented and authorized by pre-identified user contacts.

**Management's Response and Corrective Action Plan**

*CDP does require a formal change request form when the changes are initiated by the Cabinet for Health Services. CDP will require a "hard copy" request when changes are desired by other associated agencies (i.e., large metro health departments or the Department of Information Systems).*

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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CWD-28: The Division Of Unemployment Insurance Should  
Perform Regular Cash Reconciliations To Safeguard Assets**

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State Agency: Cabinet for Workforce Development

The FY 1998 audit for Unemployment Insurance contained an "other matter" condition relating to the lack of reconciliations of agency cashbooks to FAC and the bank. The prior year audit noted in its findings that the agency had not reconciled the cashbook to Farmer's National Bank since July 1997 and had not reconciled the cashbook to STARS since February 1998. In its response to the finding, the agency agreed with the auditor's finding and stated that regular reconciliations would be performed.

However, during our testing for the FY 99 audit, we found the deficiencies with the reconciliations had not been corrected. Therefore, we conclude the agency response to the FY 98 finding has been materially misrepresented.

Not reconciling to the bank or to FAC in approximately 16 months (since February 1998) could lead to material misstatements in the financial reports sent to the Federal government. The lack of reconciliations also interferes with the agency's ability to detect bank errors and STARS posting errors.

Proper internal controls dictate safeguarding of assets through reconciliations constitutes a process designed to provide reasonable assurance regarding prevention or timely detection of unauthorized transactions and unauthorized access to assets that could result in losses that are material to the financial statements. For example, the lack of reconciliation of the agency's records to STARS and to the bank accounts makes it difficult for the agency to detect unauthorized transactions through error or fraudulent behavior.

**Recommendation**

We recommend the agency perform cashbook reconciliations to the bank statements and the FAC reports. The reconciliations should allow the agency to detect posting errors made in the cashbook, as well as errors made at the bank. This should also ensure items incorrectly posted to the cashbook are detected and corrected in a timely manner.

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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CWD-28: The Division Of Unemployment Insurance Should  
Perform Regular Cash Reconciliations To Safeguard Assets (Continued)**

**Management's Response and Corrective Action Plan**

*We concur with your findings that the reconciliations were not completed as promised. We responded in good faith, indicating that we would make the reconciliations and had every intention of making good on that promise. While we had no intention to misrepresent, we realize that we did not follow through as promised. We, as an agency, are embarrassed by this failure and regret that it occurred. We recognize that the effect of this failure interferes with our ability to adequately account for the monies moving in and out of our accounts.*

*We addressed this with the personnel responsible for the errors. We are currently reviewing our internal procedures. We have set about to perform all reconciliations and will have these completed by January 1, 2000, or at some point very near thereafter.*

**COMMONWEALTH OF KENTUCKY  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CWD-29: The Division Of Unemployment Insurance Should  
Strengthen Controls Over Cash**

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State Agency: Cabinet for Workforce Development

During testing of the agency's internal controls over cash, we noted several weaknesses. We noted that one individual has the authority to sign documents, make cashbook adjustments, process drawdowns, and is also currently responsible for reconciling the cashbook. We found that access to the cashbook was not restricted, adjustments could be made after year-end, and several discrepancies occurred in the agency's cashbooks that were undetected. All the deficiencies above indicated a potential severe lapse in controls over cash reporting.

The agency cannot properly detect posting errors, unauthorized transactions, or misappropriation of funds when responsibilities over cash accounting and reporting are not segregated.

We found that access to the cashbook was not restricted, which could lead to unauthorized changes being made and going undetected. The agency does not save the data in the cashbooks as read-only to eliminate adjustments being made after each month.

In reviewing one month's Benefits cashbook, we discovered additional findings:

- We noted an entry posted both in the deposit and disbursement section of the Benefits cashbook. The entry was found to be a return check that should have only been a decrease to the deposit section of the cashbook. The deduction to the disbursement section made a misstatement of \$100 to the section.
- Unknown items were posted to the cashbook that could not be explained by the agency once brought to their attention. Without reconciling the agency records, the agency would not fully know what was outstanding at any given date or if unauthorized charges were being placed against the account. The agency only had these explained as "unknown decrease" or "unknown deposit" on the cashbook.
- Federal reports are prepared using the cashbook data that is not properly reconciled; therefore, making the information undependable and unreliable.

**COMMONWEALTH OF KENTUCKY  
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(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CWD-29: The Division Of Unemployment Insurance Should  
Strengthen Controls Over Cash (Continued)**

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- A Journal Voucher (JV) was posted one month and the same JV posted again the next month for a different amount. Since pre-printed JVs are used to prepare entries, this duplication could not be explained.
- Debits were being taken out of the bank statement due to an encoding error on the bank's behalf that had been occurring since April 1999 and was corrected only when we brought it to the agency's attention. Treasury discovered these errors when reconciling to the bank statements. This could have led to a significantly material amount had the errors remained undetected. The total effect of these errors on the fiscal year 99 audit was \$246, but the overall amount of these errors was \$669 from April 1999 to September 1999.

Proper internal controls dictate segregation of duties and a good internal control structure are required to ensure the safeguarding of agency assets.

**Recommendation**

We recommend the agency segregate the duties of agency staff to ensure appropriate controls over cash. The agency should implement a plan to ensure employees with authorization to approve documents, record cashbook entries, or drawdown funds are not responsible for reconciliation between the cashbook and STARS.

Furthermore, the agency should implement controls to ensure the accuracy of agency records, to detect misstatements in agency records and Federal reports, and to ensure agency records cannot be inadvertently changed after closing periods without detection, which could indicate errors or fraudulent behavior.

**Management's Response and Corrective Action Plan**

*Under separate cover, we have requested assistance from the Division of Quality Assurance and Consultation (QAC) [of the Office of the Auditor of Public Accounts]. We anticipate that this will assist us in detailing the systemic flaws in our accounting processes. We hope that they can make recommendations regarding the computer software needed to replace our existing spreadsheet applications.*

**COMMONWEALTH OF KENTUCKY  
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**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CWD-29: The Division Of Unemployment Insurance Should  
Strengthen Controls Over Cash (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*During the interim, we are evaluating our cashbook responsibilities and will begin segregating the functions that are now performed by one individual.*

*While we are taking immediate action on this matter, we recognize that a totally compliant system cannot be fully utilized until we meet with QAC for consultation and can install better accounting software. We expect to have the software installed and new procedures fully implemented by June 2000.*



COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

***Material Weaknesses/Noncompliances Relating to Internal Controls  
and/or Compliance:***

**FINDING 99-CWD-30: The Division Of Unemployment Insurance Should  
Ensure Computer Accounting Systems Are Operating Effectively And Amounts  
Reported From Those Systems Can Be Supported**

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State Agency: Cabinet for Workforce Development

The Branch Manager of Tax Status, in response to inquiries, reported several programming errors had delayed the balancing of the trial balance of accounts receivables for delinquent contributions. The first quarter of 1999 was not balanced until September 30, 1999 and the second quarter or fiscal year end trial balance remains unbalanced. These errors effected all areas of the trial balance—both contributing employers and reimbursing employers. These problems were not brought to the attention of the audit staff prior to this inquiry.

During the course of our audit, analytical procedures revealed a significant increase in the receivables due from reimbursing employers from FY 1998 to FY 1999. This amount had increased 125% in SFY 1999. Furthermore, the agency used the erroneous trial balance numbers in reporting Fund 62 Accounts Receivable on the AFR – 30 & AFR – 32 Closing Package Schedules.

As a result of these errors, we cannot rely on the controls of the Unemployment Insurance computer system to provide accurate reports related to employer tax including a trial balance of delinquent contributions. The system reports did not accurately reflect system inputs. The \$25,590,138 of employer tax receivable reported by the agency was based on an unverified report and therefore can not be substantiated.

The agency submitted the closing package containing unverified receivable amounts from a trial balance of delinquent employer contributions. This trial balance at June 30, 1999 has not been balanced or verified as of this date, yet the agency reported these figures without qualification in the closing package submitted to FAC.

Proper internal control dictates the outputs of a computer system accurately reflect inputs and system reports be verified prior to inclusion in external reports such as the FAC closing package.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CWD-30: The Division Of Unemployment Insurance Should  
Ensure Computer Accounting Systems Are Operating Effectively And Amounts  
Reported From Those Systems Can Be Supported (Continued)**

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FAC closing package instructions state that receivables are “the amount of revenue earned in FY 1998-99 which was not received as of June 30, 1999, and will process as a new year document.” The agency cannot provide valid evidential matter to support the amounts they reported.

**Recommendation**

The closing package submitted by the agency must be supported by balanced or verifiable documentation such as trial balances. Corrections to computer systems and additional system controls must be implemented to prevent the reoccurrence of programming errors that effect the trial balance.

**Management’s Response and Corrective Action Plan**

*We concur with the findings regarding our trial balances and not having proper procedures in place to verify the information contained in the trial balance.*

*The agency converted systems in February 1999 to prepare for Y2K. With this conversion, we encountered system and programming problems. We were delayed in the completion of the first quarter trial balance and the issuance of the 1999 tax rates.*

*Also, as a result of legislation passed by the 1998 General Assembly, beginning January 1, 1999, an employer’s tax payment is to be split between two different funds, Kentucky’s Unemployment Trust Fund and the new Service Capacity Upgrade Fund (SCUF). The programming changes to accomplish this began in 1998 and were tested prior to the live data being received. The first quarter reports were due on or before April 30, 1999. When we began auditing the reports, programming and system problems were identified and corrected.*

*Unfortunately, due to the system conversions and the implementation of SCUF, the process to complete the first quarter 1999 trial balance was not completed until September 1999 and the second quarter 1999 has not been completed. This has resulted in incorrect information on all reports that utilize the system data.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS AND QUESTIONED  
COSTS (CONTINUED)**

**FINDING 99-CWD-30: The Division Of Unemployment Insurance Should  
Ensure Computer Accounting Systems Are Operating Effectively And Amounts  
Reported From Those Systems Can Be Supported (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*Quite frankly, we have not invested any significant monies to reprogram our existing system because we are investing substantial amounts of money in a total system redesign. The Kentucky Electronic Workplace for Employment Services (KEWES) will eliminate the current trial balance process and it should provide complete, timely and accurate report information.*

*However, despite our reliance on our system redesign, we will begin to develop a back-up plan to design the necessary program upgrades that will allow us to generate the correct data required for our close-out reports in case KEWES does not become operational when planned. Additionally, we will develop procedures to verify the information provided in the closeout.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

***Reportable Conditions Relating to Internal Control and/or Compliance:***

**FINDING 99-CFC-31: The Cabinet For Families And Children Should Strengthen Controls In Preparing The Schedule Of Expenditures Of Federal Awards**

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State Agency: Cabinet for Families and Children

Federal Program: All Federal Assistance Programs

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Internal Controls

Amount of Questioned Costs: None

The Cabinet for Families and Children (CFC) prepares a Schedule of Expenditures of Federal Awards (SEFA) at year-end that lists, by CFDA number, the total Federal awards received and expended for each of its Federal assistance programs. The financial data that is used to prepare the SEFA is obtained from report 8652, which should agree to the FAC 2210 report. Accordingly, the SEFA should also agree to the FAC 2210 Report, the report that is used by FAC to prepare the Commonwealth's financial statements.

During testing, we noted weaknesses in CFC's reconciliation procedures that resulted in various errors and omissions in the agency's SEFA report:

- CFC failed to reconcile the 8652 Report to the FAC 2210.
- CFC reported \$552,154 less than the FAC 2210.
- CFC charged grant expenditures to incorrect CFDA numbers, as the amounts reported for many of the Federal assistance programs did not agree to the amounts reported in the FAC 2210.
- CFC failed to report grant #0456 associated with CFDA #93.045.

CFC's failure to reconcile the 8652 Report to the FAC 2210 caused or contributed to the following problems:

- CFC understated its expenditures by \$527,266 by omitting a grant from the schedule.
- CFC is reporting incorrect and incomplete information to the Federal government.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CFC-31: The Cabinet For Families And Children Should Strengthen Controls In Preparing The Schedule Of Expenditures Of Federal Awards (Continued)**

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- CFC overstated and understated the awards for various Federal programs, errors that could have been easily detected through reconciling.

OMB Circular A-133, Subpart C, Auditee Responsibilities, says the auditee shall “Identify, in its accounts, all Federal awards received and expended and the Federal programs under which they were received. Federal program and award identification shall include the CFDA title and number, award number and year, name of the Federal agency, and name of the pass-through entity.”

A-133 also states, “At a minimum, the schedule shall list individual Federal programs by Federal agency. . . and provide total Federal awards expended for each individual Federal program and the CFDA number or other identifying number when the CFDA information is not available.”

**Recommendation**

We recommend CFC:

- Reconcile the 8652 Report to the FAC 2210 Report prior to compiling its SEFA.
- Investigate any differences prior to compiling the SEFA.
- Code all grant expenditures to the appropriate CFDA numbers. CFC should be aware of which grants are associated with certain CFDA’s and pay special attention to see that expenditures get charged to the appropriate Federal programs.
- Include all grant expenditures in the SEFA; thus, no programs and/or expenditures should be excluded from the SEFA.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CFC-31: The Cabinet For Families And Children Should Strengthen Controls In Preparing The Schedule Of Expenditures Of Federal Awards (Continued)**

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**Management's Response and Corrective Action Plan**

*We disagree with parts of the finding:*

- 1) Report FAC 2210 is generated from data that is in STARS. This report shows total expenditures by fund and program code for each department. However, the 8652 report is generated by the Cabinet for Families and Children using the data that is in STARS. This report accumulates total expenditures by grant number, program code, and fund for all departments. The Cabinet had procedures in place to verify that total expenditures, for the 8000 series reports, agreed to the total expenditures reported on the 2000 series of STARS.*
- 2) CFC did charge the correct CFDA numbers. When federal awards are received, appropriate grant numbers are established referencing the correct CFDA. Program codes are established to capture expenditures for federal reporting. STARS edit tables ensures that expenditures post to the correct grant number. Additionally, these expenditures are reported to the federal agency, who monitors them to ensure they do not exceed federal grant awards.*
- 3) Copies of two E-Mails were sent to the auditor requesting that a meeting be scheduled so that these issues could be discussed and resolved. Since we never heard from the auditor, we thought that the issues were sufficiently explained. The Grant Management Staff have indicated that each time the auditor was here that all questions were answered to their satisfaction.*

**Auditor's Reply**

While we recognize that reconciliation procedures do exist for preparing the agency's SEFA, the existing procedures failed to detect the aforementioned errors and omissions.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CFC-32: The Cabinet For Families And Children Should Reimburse The U.S. Department For Health And Human Services For Improper Payments**

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State Agency: Cabinet for Families and Children

Federal Program: CFDA 93.596 – Child Care Mandatory and Matching Funds of the  
Child Care and Development Fund

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Internal Controls

Amount of Questioned Costs: \$105,421

CFC occasionally prepares Purchase Orders (PO) to correct prior expenditure documents that were incorrect or incomplete. While testing expenditures, we found that numerous special manual payments had been prepared to replace regular payments for the Child Care and Development Fund (CCDF). Original POs did not include reference to the replacement POs sufficient to indicate that original POs had been replaced or to locate the replacement documents. While testing POs for expenditures under Delegated Purchase Authority, we found one replacement PO in our sample, which did not include a reference to the original PO sufficient to explain its origin or to locate the original.

This lack of cross-referencing may have caused or contributed to the improper duplicate payment of three POs for CCDF. A total of \$264,137 was overpaid. To date, CFC personnel have recovered \$158,716 of this overpayment, leaving \$105,421 in unrecovered improper payments.

KRS 171.640 states, “The head of each state or local agency shall cause to be made and preserved records containing adequate and proper documentation of the . . . essential transactions of the agency . . . .”

**Recommendation**

We recommend CFC cross-reference all applicable documents when more than one expenditure document is prepared from the same invoice.

We recommend CFC reimburse the U.S. Department for Health and Human Services for \$74,185 (70.37%) of the questioned cost.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS  
(CONTINUED)**

**FINDING 99-CFC-32: The Cabinet For Families And Children Should Reimburse The U.S. Department For Health And Human Services For Improper Payments (Continued)**

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**Management's Response and Corrective Action Plan**

*We agree with the findings and recommendation.*

*We have prepared 736 JVC00007267 transferring \$74,185 of Child Care dollars from federal funds to general funds. This adjustment will be reflected on the FY2000 ACF-696 report, for the quarter ending March 31,2000.*



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CFC-33: The Cabinet For Families And Children Should Reconcile All Payments That Require Adjustments**

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State Agency: Cabinet for Families and Children

Federal Program: CFDA 93.596 – Child Care Mandatory and Matching Funds of the  
Child Care and Development Fund

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Internal Controls

Amount of Questioned Costs: \$3,839

Expenditures for the Child Care and Development Fund (CCDF) program are prepared on two documents (DOA-19s and DOA-40s) which must jointly agree or reconcile to an originating Interface Register. We tested a sample of 25 expenditures for CCDF and found that 17 of them did not agree to or fully document adjustments to the Interface Register total.

Payments of \$3,839 did not have sufficient documentation to fully support the payments that were made. The projected questioned cost for the whole population is \$6,748, an immaterial amount. However, failure to reconcile adjustments to the total due is a significant control weakness.

OMB Circular A-133, “Audits of Institutions of Higher Education and Other Non-Profit Organizations,” Compliance Supplement states, “Costs must be reasonable and necessary for the performance and administration of Federal awards.”

Good accounting practice requires that all expenditure documents be accurately and completely prepared. Good internal control requires that all accounting procedures be adequately documented to support expenditures.

**Recommendation**

We recommend CFC reconcile all payments which require adjustments to the originating STARS Interface Register, and the reconciliation should be kept on file with the documents. All necessary adjustments should be fully documented.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CFC-33: The Cabinet For Families And Children Should**  
**Reconcile All Payments That Require Adjustments (Continued)**

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**Management's Response and Corrective Action Plan**

*We agree with the recommendation.*

*The Division of Child Care has developed a filing system for the weekly KCCMS payments. These files include a hardcopy of the STARS/MARS interface register, the KCCMS 4C's system printout, the detailed funding summary sheets, and all other system generated reports relating the payment. Also in the file is a hardcopy of the related reconciliation. Each payment's reconciliation and the related documents are filed under the identifying PODC/CW number in a secure central location.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CFC-34: The Cabinet For Families And Children’s Division of Child Care Should Implement Improved Application System Controls For KCCMS**

State Agency: Cabinet for Families and Children

Federal Program: CFDA 93.596 – Child Care Mandatory and Matching Funds of the Child Care and Development Fund

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Internal Controls

Amount of Questioned Costs: \$53,669

CFC, Division of Child Care (Child Care) did not implement formal provider payment procedures until the last quarter of fiscal year ended June 30, 1999. Prior to that, manual or “special” provider payments were made without adequate supporting documentation. The provider payment procedures that were implemented still do not adequately ensure actual adjusted KCCMS payment information is appropriately captured by STARS. Specifically, our review revealed that current KCCMS payment control procedures do not include a reconciliation of KCCMS to STARS. Furthermore, procedures do not exist to ensure completeness of critical data fields within KCCMS.

An interface was developed to allow KCCMS to transmit child care related payment information to STARS for check creation and recording purposes. However, many KCCMS transactions were rejected during the interface edit process or the STARS batch edit process. KCCMS currently will not allow adjusting entries to be recorded within KCCMS once the data is closed for STARS processing. Because of this, adjustments are often made for STARS processing that are not recorded within KCCMS. This often means that the KCCMS batch totals and resulting payments will vary significantly from the actual batch totals and payments that finally get recorded within STARS.

We attempted to reconcile KCCMS related payment data sent to STARS during FY 99 with amounts actually recorded within STARS. The following problems were noted during our reconciliation:

- We could not reconcile STARS payments to KCCMS under any scenario. We attempted methods of analyzing STARS original entries and subsequent adjustments in attempts to reconcile to KCCMS. In all instances, KCCMS significantly exceeded STARS. It is apparent the main problems that hinder reconciliation efforts are adjustments are not included in KCCMS, and no methodology exists to document transactions dropped due to processing errors. It is also apparent that, although Child Care personnel ensured document totals submitted to FAC agreed to the Treasury check totals, they did not ensure STARS was properly updated.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CFC-34: The Cabinet For Families And Children’s Division of  
Child Care Should Implement Improved Application System Controls For KCCMS**  
**(Continued)**

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- KCCMS batch numbers are used as the basis to generate related STARS document numbers. These KCCMS batch numbers are prefixed with “PODC” to generate the resulting STARS document number. These PODC document numbers are a key indicator for identifying KCCMS related transactions within STARS. Therefore, the batch number within KCCMS is a critical field. However, our review revealed that the batch number had been deleted or dropped from KCCMS for certain transactions totaling \$27,531,404, or 35%, of all KCCMS transactions sent to STARS during FY 99. This made it impossible to reconcile KCCMS transactions on a document-by-document basis to STARS. Agency personnel could not provide an explanation for the missing batch numbers, nor was there an adequate database backup that included the batch numbers.
- An examination of payment files for five manual payments revealed that inadequate support existed for payments totaling \$85,330. Additionally, no supporting payment files existed for three additional manual payments totaling \$26,484. These were all Federal fund expenditures. However, adjustments totaling (\$58,145) were processed to reduce these payments. Therefore, a net total of \$53,669 will be questioned Federal costs.
- One of the five service agents contracting with the Commonwealth to oversee and process Child Care provider reimbursement requests (Community Coordinated Child Care (4Cs)) was approved to issue provider payment checks from their own system to pay Child Care providers. CFC must extract this information from the KCCMS – STARS interface file in order to reimburse 4Cs in a single check. Payments are initially charged to program code ZEGA and then must later be adjusted by journal voucher. Our review revealed five journal vouchers were processed affecting 4Cs payments totaling \$10,413,142, which did not reference the originating PODC number within the document field on the STARS history file. Instead they included the reference in the “other document” field. Therefore, queries of STARS data based on the document number would reveal inaccurate data.
- Payment schedules that are maintained by Child Care personnel to monitor manual or special payments, including 4Cs payments, often included unadjusted totals that could not be verified to final processed totals for each document. Further, in several instances the scheduled document numbers did not agree to the resulting STARS document numbers.

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CFC-34: The Cabinet For Families And Children's Division of Child Care Should Implement Improved Application System Controls For KCCMS**  
**(Continued)**

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- Payment processing procedures involved only one employee. That employee was responsible for downloading the payment file generated from KCCMS into an Excel spreadsheet, manipulating that data and formatting it to interface with STARS, extracting 4Cs or erroneous data, and finally uploading the resulting file to the mainframe for FAC to process. That employee has full capability to alter vendor or payment information while it is in the Excel format. Currently, there is no supervisory role involved that would act as a control to ensure the propriety of any changes to payment amounts or vendor information.

The primary reasons for these problems appear to be partially due to personnel changes within the agency during FY 99, and the failure to develop and implement timely procedures that would require Child Care personnel to monitor processing and output control totals for accuracy and completeness. However, additional problems have occurred due to the fact that developed procedures were not sufficient or comprehensive. Procedures do not adequately track record counts and transaction dollars completely through the STARS update process.

The failure to establish proper controls to ensure the accuracy and completeness of data processing and output can result in incomplete or inaccurate system information and could affect any related payments. Specifically, in this case it resulted in \$53,669 of questioned Federal expenditures.

**Recommendation**

We recommend that Child Care consider taking the steps necessary to modify KCCMS to ensure that the system properly reflects adjustments that are made to closed payment batches. This activity should be allowed only under proper security controls with consideration given to adequate segregation of duties. Child Care management should modify their current procedures to ensure adequate processing controls are established. These controls should include control total monitoring procedures to log initial KCCMS payment data by batch, number and dollar amount of transactions dropped during the STARS interface process (or KCCMS edit process), and the net payment amounts submitted to STARS. Child Care should also implement supervisory controls over the STARS interface file creation and any error processing procedures, and implement procedures to ensure the completeness of critical KCCMS database fields.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS  
(CONTINUED)**

**FINDING 99-CFC-34: The Cabinet For Families And Children’s Division of  
Child Care Should Implement Improved Application System Controls For KCCMS  
(Continued)**

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**Recommendation (Continued)**

Further, the agency should perform a periodic reconciliation of KCCMS to STARS (or MARS) on a document level and total basis periodically. Finally, we recommend the agency obtain supporting documentation for the payments noted above concerning Federally questioned costs.

We realize that MARS, the new Commonwealth Management and Reporting System, may alleviate the STARS interface concerns due to using a check writer system for KCCMS related payments. However, we assume processing will still entail the creation of a check tape from KCCMS that will interface with the check writer system of MARS. There will still be issues of error kick-outs that will require manual intervention and possibly manual check payments. Therefore, procedures will still be required to ensure control totals are monitored for check tape creation, resulting check data produced, and to ensure that error processing and resubmission is properly handled. The agency must still be able to reconcile KCCMS figures with actual payments.

**Management’s Response and Corrective Action Plan**

*During FY00 many changes occurred as the result of reorganization and division restructuring. Various stages of the KCCMS payment processing functions moved from Office of Financial Mgt. and the OTS/KCCMS portion of the payment process is now overseen and controlled within DCC Fiscal area. The centralizing of payment function responsibility gives DCC greater security controls over the complete payment process.*

*With the implementation of the Management Administrative and Reporting System (MARS) in July 1999, the concerns expressed by the auditor have been alleviated. In conjunction with the CFC-Office of Technology Services, the Division of Child Care has implemented new automated edit procedures to capture payment processing errors prior to the creation of check writing procedures and uploads*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CFC-34: The Cabinet For Families And Children's Division of**  
**Child Care Should Implement Improved Application System Controls For KCCMS**  
**(Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*to MARS. Any transactions with errors are now captured and hardcopy documentation is maintained at the central office level. Next, the status of the transaction is changed to force the transaction back to the broker to be corrected and processed in the next regular payment run. This process is automated and there is no longer human intervention or file manipulation involvement at the central level.*

*Standardized procedures are also being implemented for issuance of manual or special payments to brokers. Since January 2000, we have only had to issue six manual payments. Standardized procedures will include requirements for adequate supporting documentation of all manual payment requests. DCC staff is extensively researching the supporting documentation in reference to the \$53,669 question federal costs.*

*Additionally, as of January 2000, the 4C's broker related payments are processed using the same methodology as used for all other brokers. The payment process no longer involves downloading of data files into spreadsheets. Payment files are automatically generated and processed to check writer files that are forwarded to Finance for approval, and then on to the KY State Treasurer for check printing and issuance. Two Child Care employees will share payment-processing duties to ensure adequate supervision. These duties will include tracking and resolution of any variances between the KCCMS payment listings and the resulting check listing from Mars. With the auditor's recommendation to perform a periodic reconciliation of KCCMS to STARS (or MARS) on a document level, DCC developed additional payment procedures to document the reconciliation of KCCMS figures with actual payments processed through MARS Checkwriter. DCC currently is developing a monthly reconciliation year to date tracking process of KCCMS Interface Register, Adjustment, MARS's expenditures and Revenue Intercept amounts totals.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CFC-34: The Cabinet For Families And Children's Division of**  
**Child Care Should Implement Improved Application System Controls For KCCMS**  
**(Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*DCC continually strives to identify potential problems within the KCCMS system, then working with CFC-Office of Technology and Governors Office of Technology, test and resolve the issues. We know that the current system is technologically complex making instances of problems difficult if not impossible to explain. A new system is currently in development but is yet to be tested and approved. Further, when Finance approves a payment run, a CWST assigned tracking number references Checkwriter file to the KCCMS payment file, this should alleviate any problems previously encountered concerning missing document numbers. In addition the KCCMS document file number is printed on each check for further identifying tracking purposes.*



**COMMONWEALTH OF KENTUCKY  
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(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS  
(CONTINUED)**

**FINDING 99-CFC-35: The Department For Disability Determination Services  
Should Improve Program Modification Procedures**

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State Agency: Cabinet for Families and Children

Federal Program: CFDA 93.596 – Child Care Mandatory and Matching Funds of the  
Child Care and Development Fund

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Internal Controls

Amount of Questioned Costs: None

As noted in the prior two audit periods, the Department for Disability Determination Services (Disability) did not develop and implement formalized policies and procedures to properly control program modifications. Further, we still noted a segregation of duty conflict between their systems support and program control personnel.

Disability had contracted with an external software vendor, I. Levy & Associates, Inc., which supports the Disability Case Tracking System (DDS). I. Levy & Associates, Inc. performs the requested program modifications for DDS. Users informally submit program modification requests to the employees of the Systems Operation Section (SOS). The employees of SOS have meetings to discuss the suggested application changes. Once an agreement is reached as to the required program modifications, the request is entered into a log. At this point, a Disability employee contacts the external vendor to request a program modification. Our audit revealed that one employee within SOS was primarily responsible to coordinate the program modification request process with the software vendor. This process consists of the SOS employee sending a fax, e-mailing via the Internet, or simply placing a telephone call to the software vendor. The auditor noted that SOS maintained a file that contained copies of modification requests with handwritten notes on the copies. These copies and notes were used to informally track the requests. The status of the requested program modifications could not easily be determined.

Also, FY 99, SOS personnel received requested program changes from the software vendor as zip files without encryption. SOS performed procedures to check these files for viruses and to test programs prior to implementation. However, these procedures were not formally documented, nor did they have formal procedures to document the completion or results of testing

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CFC-35: The Department For Disability Determination Services  
Should Improve Program Modification Procedures (Continued)**

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Finally, the same employee responsible for submitting change requests to the vendor was responsible for moving program modifications into production. That employee also acted as a backup security administrator with full system access, including access to the source code. No procedure was in place to ensure that each change had been appropriately tested prior to being moved into production.

We noted during FY 99, a tracking system database was designed. This database will track system program changes, as well as prioritize requests. The auditor observed the designed template containing fields available to capture the date of request, the due date to complete the request, the date of test and program change status. Once implemented, this system will satisfy most prior year recommendations relating to program modification. In addition, this system will provide information for library maintenance and control, an audit trail of changes for each modification, and will prompt for program modification tests. SOS personnel tested this database during our fieldwork period. However, this system had not been implemented at the time of our fieldwork.

Formalized policies and procedures are needed to ensure procedures to authorize and approve program modifications are consistently applied. Further, policies and procedures are required to ensure the development of technical and user documentation, library maintenance and control, sufficient user training, standardized testing requirements, adequate tracking of requests, the transfer of changes into production, and an audit trail of program changes. Also, proper segregation of duties should be maintained between programmers, or personnel with program update capabilities, and systems support personnel.

Without formalized controls governing program modifications, management increases the risk that incorrect or unauthorized changes could be moved into the production environment and adversely affect system processing. Also, without a formal documented system for tracking program modifications to completion, it would be difficult for Disability to know the status of requested changes or if they are being billed for services they did not request. Failure to maintain proper segregation of duties for programmers and systems support personnel increases the potential that unauthorized changes could be made to programs, data files or operating systems.

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CFC-35: The Department For Disability Determination Services  
Should Improve Program Modification Procedures (Continued)**

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**Recommendation**

We recommend that Disability management develop and implement formal written program modification control procedures. The procedures should address the following issues:

- Authorization and approval of changes
- Technical and user documentation
- Tracking of requests
- Testing requirements and tracking
- Library maintenance and control
- An audit trail of changes to each program
- Virus scanning of program modules received over the Internet

**Management's Response and Corrective Action Plan**

*We would like to add to the emphasis that this is a departmental processor and the issues of separation of responsibilities are not resolvable on this machine. The operating concept of this machine is that users manage the system themselves. As a result the facilities for segmenting and dividing the duties are not there. The operating system recognizes only security administrator and "all others" (the latter is not a defined group at all). The security administrator can limit access for all the others, but cannot create a group that can work with programs but not data, or add and delete programs but not access security. To install and remove programs you need controlling access to that class of program. That same access allows the user to run the program and perform whatever functions the program does. Some of the controls requested cannot be done on this machine while also using the same machine for production. Since your last review, we began the process of migrating the application from the Wang environment to an IBM AS400. In preparation for the move we began looking at change control software to use during the migration. It was quite clear after reading the descriptions that this type of product was what your recommendations were pointing to. We have yet to find any kind of change control software for the Wang environment. However, we do have a tool that I Levy built for us that helps keep different software loads separate from each*

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**(CONTINUED)**

**FINDING 99-CFC-35: The Department For Disability Determination Services**  
**Should Improve Program Modification Procedures (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*other. It groups programs by date received, lets us load them to either test or live systems as a group, and then moves the older versions and marks them as a group, should we need to quickly replace them into production. This provides a very basic functionality of change/version control.*

**Auditor's Reply**

It appears our security concerns surrounding this system will be completely alleviated only after migration off of the WANG server sometime in 2003. Until that time, we request Disability and SOS management focus on formalizing program modification related procedures as much as possible, improve tracking of requests, and document major modification test results at least in a summary format. Close supervisory review of program changes in the WANG environment is suggested until a full migration to the AS400.

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**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CHS-36: The Department For Medicaid Services Should Improve  
The Controls Over Drug Rebate Billings, Collections, And Recording**

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State Agency: Cabinet For Health Services

Federal Program: CFDA 93.778 - Medical Assistance Program

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Entity: Not Applicable

Compliance Area: Special Tests and Provisions

Amount of Questioned Costs: None

During our testing of internal controls over the Drug Rebate Program, we noted several weaknesses in various areas of the Program. First, we tested 40 Rebate Billing Statements for accuracy, timeliness, and for proper recording. We tested these billings from the billing cycle through the receipt cycle. Weaknesses were noted in five areas. Three of these areas were findings in our SSWAK 97 audit report as 97-CHS-44 and are listed on the Summary Schedule of Prior Audit Findings in this report. The other two exception are new findings and are noted below:

- Six amounts posted as received from the labeler did not equal the amount of the check.
- No initials documenting who performed the Drug Rebate reconciliation was noted. In addition, there was no review by an appropriate supervisor of the reconciliation after they were performed.

The lack of an effective internal control structure increases the risk that laws and regulations of the Drug Rebate Program will not be followed, leading to the possibility of sanctions by the Federal government, including possible disallowance of expenditures. Furthermore, since a portion of the rebate collected would be used to reimburse the Commonwealth for its match, failure to collect all rebates due results in a loss of state revenue.

The Drug Rebate Program was established within the Medicaid Assistance Program (MAP) by Federal law to recover from drug manufacturers a fee per drug unit dispensed by providers of Medicaid services. It is DMS's responsibility to establish internal controls to properly record, collect, and report all amounts owed to and received by MAP.

**COMMONWEALTH OF KENTUCKY  
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(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CHS-36: The Department For Medicaid Services Should Improve  
The Controls Over Drug Rebate Billings, Collections, And Recording (Continued)**

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**Recommendation**

We recommend proper controls be implemented by the fiscal agent or by DMS to ensure the following objectives are met:

- All check amounts posted should equal the labeler quarter detail screens (manufacturer's account).
- Drug Rebate reconciliations are performed and initialed by the preparer. In addition, the reconciliation is reviewed by an appropriate supervisor once it has been performed.

**Management's Response and Corrective Action Plan**

*The Department agrees with the auditor's comments and has developed written procedures for the reconciliation of reports. Additionally, the Department is operating under a new contract with Unisys and has changed the monitoring techniques used. A Report Card process is being put in place that puts emphasis on the Ad Hoc arena.*

**COMMONWEALTH OF KENTUCKY  
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FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS  
(CONTINUED)**

**FINDING 99-CHS-37: The Cabinet For Health Services Should Improve  
Subrecipient Monitoring Procedures At The Department For Public Health**

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State Agency: Cabinet For Health Services

Federal Program: CFDA 93.994 - Maternal and Child Health Services Block Grant to the  
States

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Entity: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: None

The FY 98 audit of CHS, Department for Public Health, disclosed a reportable condition relating to the lack of procedures in place for the monitoring of subrecipients, as required by OMB Circular A-133. During our audit of the Maternal and Child Health Services (MCHS) program and the Immunization program, we again noted that the monitoring of local/regional health departments (subrecipients) was unsatisfactory. The local health departments are required to have an audit performed annually. These audits were performed and most of these audits had been completed as of February 2, 2000. A desk review of these audits was not performed as of the same date.

In the agency's response to our audit finding for FY 98, CHS indicated that local health department audits had always and would continue to be reviewed using the "Desk Review Guide for Single Audit Reports." Because of an internal reorganization of the local Fiscal Management staff, in which duties and responsibilities of staff had been shifted, a situation was created in which those audits reviews had not been performed. In addition, the agency agreed with the audit recommendations that those reviews should be completed to ensure audit requirements are met, corrective action taken, and reviews of the audit reports are documented and performed in a timely manner. However, there have not been any continuing efforts to review the audits. The audits appear to have been logged in by CHS, yet they did not use these reports to verify the monitoring.

Therefore, based on the results of our audit for FY 99, we conclude CHS has materially misrepresented their corrective action plan.

CHS, and their subsequent Federal programs, cannot be assured that their subrecipients are conducting financial operations in accordance with Federal requirements.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
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(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CHS-37: The Cabinet For Health Services Should Improve Subrecipient Monitoring Procedures At The Department For Public Health (Continued)**

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The Federal Attachment A, Single Audit Act Amendments of 1996, Subpart D, section 400, (d) (3-6) and the Department for Public Health, Division of Financial Resource Management, Audit Review Procedures, require pass-through entities monitor the activities of subrecipients, ensures audit requirements are met, and take appropriate and timely corrective action. In addition, local health departments obtain an audit and the Financial Management Branch should review these audits.

**Recommendation**

We recommend the current financial audit reports for the local and regional health departments receive a timely review and the results of these reviews be communicated to all grant administrators.

**Management's Response and Corrective Action Plan**

*At the time of the APA audit, the audit reports submitted to the Department of Public Health (DPH) by the Local Health Departments (LHDs) had not been reviewed due to the staff shortages and other priorities. The Department agrees that the timely review of audit reports and dissemination of information to appropriate program administrators is necessary to good administration of our programs. Staff are currently being trained to use the "Desk Review Guide for Single Audit Reports" as the appropriate tool for use in reviewing audit reports submitted by LHDs, and will endeavor to make timely reviews a top priority.*

**Auditor's Reply**

The agency should make a serious effort in completing the review of the local health department audits. Currently, the agency is two fiscal years behind in completing these reviews. We believe this could have an effect on the funding of various Federal programs, since CHS is required by OMB Circular A-133 to monitor subrecipient activities.



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(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-TC-38: The Division Of Right Of Way Should File All Real Property Deeds In The Project Parcel Files Timely**

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State Agency: Transportation Cabinet

Federal Program: CFDA 20.205 – Highway Planning and Construction

Federal Agency: U.S. Department of Transportation

Pass-Through Agency: Not Applicable

Compliance Area: Real Property Acquisition and Relocation Assistance

Amount of Questioned Costs: None

Procedures are not adequate to ensure that all deeds for real property are filed in the parcel files in the Right of Way file room. This comment has been an “other matter” comment in the audit years FY 96, FY 97, and FY 98.

During our audit testing of the Acquisition of Real Property for Division of Right of Way, we noted the following problem:

- Of the 40 parcel files tested, 15 files were missing the deeds that should have been present. These 15 deeds were later found, but were not found in the parcel files when the audit test was conducted, which was more than 8 months after the close of the fiscal year in which the parcel purchases were made. In the previous audit, there were 9 such occurrences in the 40 files tested.

Deeds that are lost or mislaid for any period of time affect the Cabinet’s ability to provide the best and most effective controls over rights to acquired properties. Missing deeds may go years without being detected, as it may take years before the Right of Way project is completed and then reviewed before being archived.

**Recommendation**

We recommend that the Division of Right of Way implement stronger internal controls to assure the proper filing of the deeds in the parcel files in a timely manner so that the State’s property rights are safeguarded.

As this comment has been made in the past without adequate resolution of the problem, new procedures may be necessary to adequately monitor compliance with guidelines.

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**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-TC-38: The Division Of Right Of Way Should File All Real  
Property Deeds In The Project Parcel Files Timely (Continued)**

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**Management's Response And Corrective Action Plan**

*The Cabinet agrees with the finding and recognizes the importance of strong internal controls for the maintenance of the right of way files. However, the problem has largely been the result of a heavy workload combined with staffing limitations. The Division of Right of Way & Utilities is attempting to obtain additional staffing for the filing function. The hiring of additional staff is the responsibility of the Division's Director. This effort will begin immediately and it is planned that staff will be hired no later than December 31, 2000 for this function.*

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(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CWD-39: The Office Of Training And ReEmployment Should Ensure Federal Reports Can Be Verified Through Supporting Documentation**

State Agency: Cabinet for Workforce Development

Federal Program: CFDA 17.250 - Job Training Partnership Act and CFDA 17.246 -  
Employment And Training Assistance - Dislocated Workers

Federal Agency: U. S. Department of Labor

Compliance Area: Reporting

Amount of Questioned Costs: None

The Office of Training and ReEmployment (OTR) submits JTPA Quarterly Status Reports (JQSR) for Title II of JTPA, and Worker Adjustment Formula Financial Reports (WAFFR) for Title III of JTPA, to the Federal government on a quarterly basis. Since JTPA grants have a three-year period of availability, separate quarterly reports are required for each open grant. We reviewed these reports for the quarter ended June 30, 1999 and found a lack of supporting documentation resulting in several errors.

The effects for the JQSR are as follows:

1. The Older Individual expenditure amount on the PY 96 JQSR shows \$615,635 in expenditures. However, the supporting documentation for the report indicates the amount to be \$614,011, a difference of \$1,624.
2. STARS 7110 reports used to calculate the State Education Services amounts on the JQSR for PY 97 (grant 0274-98-00) supported \$797,469 of the \$1,016,448 reported. This leaves \$218,979 unsupported. Since the grant year for PY 97 has not closed, we consider this an error.
3. Also, the JQSR for PY 97 did not include the closeout amounts, resulting in a difference of \$6,611. This is also an error.

The effects for the WAFFR are as follows:

1. The agency's WAFFR calculations for PY 98 included the Rapid Response expenditure for Eastern Kentucky Concentrated Employment Program (EKCEP) twice, once as administration and once as rapid response. Thus, the administration amount reported in Section I of the WAFFR was overstated by \$2,431.

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**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CWD-39: The Office Of Training And ReEmployment Should Ensure Federal Reports Can Be Verified Through Supporting Documentation**  
**(Continued)**

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2. The PY 97 Program total reported in Section I Governor's Reserve Funds was \$3,718,042. According to the supporting calculations provided, the total Basic Readjustment and Retraining amount was \$3,704,010. Therefore, it appears the Section I Program total is overstated by \$14,032. This includes \$1,253 from the OTR line in the calculations, which was not supported.

Proper internal controls dictate the agency maintain adequate supporting documentation for reports submitted to the Federal government.

20 CFR 627.425 (a) (1) states, in part, "The financial management system . . . of each recipient and subrecipient shall provide federally required records and reports that are uniform in definition, accessible to authorized Federal and State staff, and verifiable for monitoring, reporting, audit, program management, and evaluation purposes (sections 165(a) (1) and (2), and 182)."

**Recommendation**

We recommend the agency review the above effects and determine if any adjustments to future reports or amendments to previous reports are necessary. Also, the agency should implement controls to ensure maintenance of adequate supporting documentation along with copies of the reports in the future.

**Management's Response and Corrective Action Plan**

1. *The auditors state that the PY96 JQSR report shows \$615,635 in Older Worker expenditures, while the supporting documentation shows \$614,011, resulting in \$1,624 in questioned cost. The \$1,624 in Older Workers expenditures that the auditors are questioning is because the backup as of 6/30/99 for NCKC shows a balance of \$1,624. When questioned, NCKC staff stated that when they reported their final June, 1999 report that all of the older worker funds would be fully expended. That is why the JQSR report showed the entire amount as expended. However, the final June 1999 invoice received from NCKC showed an unexpended balance of \$1,102. This invoice was not received by OTR until October 1999, which is after the JQSR report for 6/30/99 was filed.*

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**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS  
(CONTINUED)**

**FINDING 99-CWD-39: The Office Of Training And ReEmployment Should  
Ensure Federal Reports Can Be Verified Through Supporting Documentation  
(Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

2. *The JQSR report was filed based on adding current year expenditures to the amounts reported for the prior year. The current year expenditures did agree with the amount reported on the current year 7110 reports. However, the amounts reported for the prior year were prepared by staff that was no longer employed by the 8% Education Coordination Branch. The new employee who prepared the JQSR report for the quarter ended 6/30/99 was not aware of how the prior year figures were calculated. It is possible that the prior employee included some anticipated adjustments in the figures reported on the 6/30/98 JQSR report that would also be included in the current year 7110 expenditure reports.*

*OTR agrees to adjust PY97 State Education amounts reported on the future JQSR reports to agree with the amounts reported in STARS for the PY97 grant.*

3. *The closeout amounts in question were probably not included in the JQSR reports because the 7110 closeout reports were probably not received by the filing date of the report. However, OTR agrees to adjust PY97 State Education amounts reported on the future JQSR reports to agree with the amounts reported in STARS for the PY97 grant.*

*The response to the effects on the WAFFR are as follows:*

1. *OTR agrees that the \$2,431 rapid response amount was included twice on the WAFFR report. This occurred because the prior invoices reported the \$2,431 amount as rapid response but a monthly invoice was sent in to OTR without changing the description from administration to rapid response. The amount was then entered again in the administration column. We agree to correct future quarterly reports by reducing the administration amount by the \$2,431 over reported.*
2. *OTR agrees that the \$3,718,042 amount reported as program expenditures was overstated by \$14,032. However, the \$14,032 amount should have been reported as rapid response, and it was not. Therefore the total amount of expenditures reported was correct. OTR agrees to correct this classification error for PY97 in future quarterly reports.*

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**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CWD-40: The Department For Employment Services Should Implement Controls To Ensure All Applicable Regulations And Program Policies Are Followed In Their Administration of Federal Programs**

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State Agency: Cabinet for Workforce Development

Federal Program: CFDA 17.246 - Employment And Training Assistance - Dislocated Workers

Federal Agency: U. S. Department of Labor

Compliance Area: Allowability

Amount of Questioned Costs: \$613,950

During our testing of allowable activity for JTPA, we noted instances in which some Substate Grantee (SSG) expenditures had been charged against the allotments of other SSGs. It appears that the Department for Employment Services (DES) transferred expenditures among the various SSGs. These transfers have resulted in disallowed expenditures for those substates, which have been charged for the activities of another area. Therefore, expenditures totaling \$613,950 are questioned as a result of the following transactions:

- \$164,300 of Other Care and Support expenditures from the Bowling Green (Barren River) SSG were charged to the Hopkinsville SSG.
- \$42,500 of Other Care and Support expenditures from the Bowling Green SSG were charged to the Elizabethtown SSG.
- \$170,100 of Other Care and Support expenditures from the Covington SSG were charged to the Ashland SSG.
- \$237,050 of Other Care and Support expenditures from the Somerset SSG were charged to the Lexington SSG.

JTPA regulations specifically forbid the shifting of costs for any reason. Direct expenditures must be charged against the subrecipient award of the SSG that performed and administered the activity or initiated the costs. These expenditures cannot be charged to other SSG awards since those areas have no administrative control, oversight, or monitoring of the activity.

Further, FY 99 JTPA Title III administrative expenditures were limited to 20% of allocated funds. The transferring of expenditures among the substate areas circumvents this cost limitation by allowing SSGs to maintain the full amount of their administration allowance. For example, one of the contiguous adjustments moved \$164,300 of expenditures from the Bowling Green SSG to the Hopkinsville SSG. Had the allocation been transferred instead of the expenditures, the Hopkinsville SSG would have forfeited \$32,860 (\$164,300 X 20%) of the funds available for administrative costs.

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**(CONTINUED)**

**FINDING 99-CWD-40: The Department For Employment Services Should Implement Controls To Ensure All Applicable Regulations And Program Policies Are Followed In Their Administration of Federal Programs (Continued)**

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In addition, the transfer of expenditures among SSGs misrepresents expenditures to the oversight agency. Therefore, it interferes with the oversight agency's ability to analyze regional expenditures for the provision of services and for future allocations.

Per JTPA regulations, allowable costs must be necessary and reasonable expenses and allocable to the program.

20 CFR 627.435 (a) states, "To be allowable, a cost shall be necessary and reasonable for the proper and efficient administration of the program, be allocable to the program, and, except as provided herein, not be a general expense required to carry out the overall responsibilities of the Governor or a governmental subrecipient."

While JTPA regulations would permit the combination or transfer of funds allocated to contiguous substate areas, they specifically prohibit the transfer of costs among substate grantees.

20 CFR 631.14 (h) states, "Combination of funds. (1) Substate Grantees within a State may combine funds allocated under part A of Title III for provision of services to eligible dislocated workers from two or more substate areas. Funds contributed by the substate grantees under this section remain subject to the cost limitations, which apply to each substate grantee's total allocation (section 315 (d)). (2) To combine funds under this provision substate grantees must be in contiguous substate areas or part of the same labor market area."

20 CFR 627.435 (c) states, "Costs allocable to another Federal grant, JTPA program, or cost category may not be shifted to a JTPA grant, subgrant, program or cost category to overcome fund deficiencies, avoid restrictions imposed by law or grant agreements, or for other reasons."

20 CFR 631.14 (c) states, "Of the funds allocated to the Governor, or allocated to any substate grantee, under Part A of Title III for any program year, not more than 15 percent may be expended to cover the administrative cost of programs." (Auditor note: A waiver granted by DOL for PY 1998/FY 1999 increased this limitation to 20%.)

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**(CONTINUED)**

**FINDING 99-CWD-40: The Department For Employment Services Should Implement Controls To Ensure All Applicable Regulations And Program Policies Are Followed In Their Administration of Federal Programs (Continued)**

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**Recommendation**

We recommend that DES rectify \$613,950 in questioned costs and implement controls to ensure that all applicable regulations and program policies are followed in their administration of Federal programs.

Furthermore, we recommend that OTR monitor DES's corrective actions to rectify the questioned costs. In addition, OTR should also review DES transactions for all JTPA grants open during the 1999 fiscal year to determine if there are any additional disallowed costs related to the transferring of expenditures.

**Management's Response and Corrective Action Plan**

*This finding questioned all costs related to the manner in which DES implemented the provision in the JTPA Law at Sec. 315(d) and at CFR 631.14 (h). This provision, which was new with the JTPA Amendments of 1992, allows contiguous substate grantees to combine funds for the provision of services to eligible dislocated workers. The combination of funds clause is uniquely different than a reallocation of funds as had always existed in the program. The State grant recipient also had their own policies regarding voluntary reallocations between subgrantees that existed both before and after the amendments that allowed for the transfer of Program Category funds only. These policies are also distinctly different than the contiguous substate combination of funds per the above cited paragraphs of the Law and Regulations.*

*In [CFR] 631.14 (h)(1) it states that "Funds contributed by the substate grantees under this section remain subject to the cost limitations which apply to each substate grantee's total allocation. This seems to say that the combination of funds does not change those funds identity from how they were originally allocated and each substate grantee involved in such a combination of funds must still apply the limitations to their total allocation as if a combination wasn't occurring. So how in practice are substate grantees to affect such a combination?"*



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**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
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**FINDING 99-CWD-40: The Department For Employment Services Should Implement Controls To Ensure All Applicable Regulations And Program Policies Are Followed In Their Administration of Federal Programs (Continued)**

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**Management’s Response and Corrective Action Plan (Continued)**

*It was understood by DES that the intent of these provisions was to dissolve the boundary between contiguous areas allowing subgrantees to approach services for the sum of the areas while each area maintains their specific allocations. How else can this be achieved other than one subgrantee stretching their funds across the boundary to serve participants in the contiguous area. This is achieved by the expenditure of funds by one of the subgrantees in support of participants in the other subgrantee area.*

*Further, the substate grantees apply cost limitations against funds allocated to the substate grantee as defined in CFR 631.14 (i)(2) where it says “allocated by formula prescribed by the Governor under section 302(b) of the Act, and allocated (or distributed) under the provision of section 302(c)(1)(E), as adjusted by within State reallocations implemented by the Governor through procedures established pursuant to section 303 (d) of the Act.”*

*So, cost limitations are applied against the formula allocation plus any additional allocations of Governor’s Reserve, plus/minus any involuntary allocations done as a result of not meeting expenditure requirements. No mention is made of the combination of funds provision at 631.14(h) or of any voluntary reallocations that may have taken place according to State policy. Again, the combination clause of the JTPA Amendments was intended to provide a new and additional flexibility to contiguous areas in how funds may be expended to serve the combined areas.*

**Auditor’s Reply**

The agency’s response centers on the provision in the regulations at 20 CFR 631.14 (h), which allows contiguous substate areas to “share” allocated funds. We do not dispute that the regulations grant the ability to transfer funds. However, the finding resulted from transactions involving the transfer of expenditures not allocated funds. The regulations at 20 CFR 627.435 (c) specifically prohibit the transfer of expenditures for any reason.

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**FINDING 99-CWD-40: The Department For Employment Services Should Implement Controls To Ensure All Applicable Regulations And Program Policies Are Followed In Their Administration of Federal Programs (Continued)**

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**Auditor's Reply (Continued)**

In response to auditors concerns that the transfer of expenditures was essentially a method of circumventing the earmarking (cost limitation) provisions, the agency alludes that this was the intent of the regulations in order to give grantees greater flexibility in the way that funds were expended. We do not believe that the intent of this regulation was to eliminate the earmarking limitations. In fact, the regulation stipulates that "funds contributed . . . under this section remain subject to the cost limitations."

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(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CWD-41: The Division Of Unemployment Insurance Should Ensure Supporting Documentation Used In Preparation Of Federal Reports Is Accurate**

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State Agency: Cabinet for Workforce Development  
Federal Program: CFDA 17.225 - Unemployment Insurance  
Federal Agency: U. S. Department of Labor  
Compliance Area: Reporting  
Amount of Questioned Costs: Unknown

During the testing of compliance for the Unemployment Insurance (UI) reporting requirement, we noted the following exceptions:

- The ETA 191 and ETA 2112 both rely on the agency cashbook for supporting documentation. The agency cashbook was found to be unreconciled and erroneous in Phase I of the audit. Therefore, these Federal reports are not using a reliable source of information. We were unable to determine the amount of the error due to the unreconciled cash records.
- The ETA 581 was found to be inaccurately stated due to double adjustments made from noncompliance with agency procedures. The agency was not complying with the set procedures to audit the processed payments before making adjustments. The magnitude of this discrepancy could not be calculated due to the fact that the actual population of double adjustments could not be determined.

The source data for the Federal reports are unreliable agency records. Therefore, inaccurate Federal reports are submitted and UI financial data is misstated, which could impact Federal funding decisions.

Proper internal controls dictate that accurate information should be presented when preparing and transmitting Federal reports, which can be supported by valid accurate supporting documentation.

**Recommendation**

We recommend the Federal reports be corrected and only use valid, accurate supporting documentation in preparation of these reports.

We also recommend controls be implemented to ensure double adjustments are not recorded. The agency needs to ensure audits are performed in a timely manner to prevent duplication of adjustments.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CWD-41: The Division Of Unemployment Insurance Should Ensure Supporting Documentation Used In Preparation Of Federal Reports Is Accurate (Continued)**

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**Management's Response and Corrective Action Plan**

*We agree that the Federal ETA 191 and ETA 2112 reports are in error as a result of our failure to reconcile our tax and benefits cashbooks. This was also noted in our last audit and while we have made some progress in correcting the problem, we clearly recognize that we have not completed all reconciliations. We also agree that we have not met our projected deadlines for having these completed. We believe that this will be accomplished by June 30, 2000.*

*We also agree that our accounts receivable data source for the ETA 581 report is unreliable, and as discussed with the auditor during the review, this is symptomatic of a greater problem than reporting accuracy. The agency no longer has adequate staff to maintain the existing accounting system in a timely fashion. The solution is a new system, which is presently under development as part of the agency's electronic workplace initiative (KEWES) in partnership with KPMG. The new system will address the auditor recommendations for improvement by building automated controls into the account adjustment (journal entry) process to prevent many of the problems that occur in the present manual process and by enabling the agency to complete the audit of quarterly tax reports within a few weeks following the due date (as opposed to the several months now required).*

*The timetable for implementation of the new system is dependent upon completion of another project outside of agency control, the Revenue Cabinet Modernized Front End (MFE) system. Upon completion of the UI portion of the MFE system, processing of UI tax reports and payments will be transferred to the Revenue Cabinet, which will greatly reduce the time required to open reports, deposit payments, and enter the data from the reports, allowing our agency to begin the audit process much sooner. Unfortunately, the MFE system is now approximately six months behind schedule, which has delayed implementation of our new accounting system.*

*At this time it is expected that processing on the MFE system will begin no earlier than June 1<sup>st</sup>. Assuming this date is met, we expect to fully implement the new tax accounting and adjustment system within three to six months following MFE availability.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS  
(CONTINUED)**

**FINDING 99-CWD-41: The Division Of Unemployment Insurance Should Ensure Supporting Documentation Used In Preparation Of Federal Reports Is Accurate (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*We would like to respectfully disagree with the auditor's statement that the effect of the noncompliance, "could impact federal funding decisions". We do not believe this could have any effect on our agency funding.*

COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

*Material Weaknesses/Noncompliances Relating To Internal Controls  
and/or Compliance:*

**FINDING 99-CFC-42: The Cabinet For Families And Children Should Monitor  
Subrecipients Of TANF Funds In Accordance With OMB Circular A-133**

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State Agency: Cabinet for Families and Children

Federal Program: CFDA 93.558 - Temporary Assistance for Needy Families

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: None

CFC contracts with the Transportation Cabinet, who then subcontracts with 16 different regions to provide transportation services to TANF recipients and children. During FY 99, CFC sent \$11,626,770 in Federal monies to various regions to carry out TANF program objectives, but failed to monitor these subrecipients due to understaffing.

Under OMB Circular A-133, CFC, acting as a pass-through entity, is responsible for monitoring the activities of its subrecipients to ensure that the TANF program is being administered efficiently and that grant monies are spent in accordance with Federal laws and regulations. CFC is aware of the requirements of OMB Circular A-133.

CFC cannot be assured that subrecipients are spending grant monies for their intended purpose and acting in accordance with the requirements of OMB Circular A-133.

OMB Circular A-133, Part 3 – Compliance Requirements, section M. Subrecipient Monitoring says, “A pass-through entity is responsible for . . . monitoring the subrecipient’s activities to provide reasonable assurance that the subrecipient administers Federal awards in compliance with Federal requirements.”

**Recommendation**

CFC, using existing resources, should implement a system for monitoring the 16 regions.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CFC-42:** The Cabinet For Families And Children Should Monitor Subrecipients Of TANF Funds In accordance With OMB Circular A-133  
(Continued)

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**Management's Response and Corrective Action Plan**

*The Division of Outcome Based Contracts, Contracts Accountability Branch is responsible for monitoring Cabinet contracts. Beginning with SFY 2000, the branch will use the attached tools [agency created written Monitoring Tool] to monitor the TANF transportation contract with the Transportation Cabinet. This tool includes areas that relate specifically to subrecipients.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CFC-43: The Cabinet For Families And Children Should Establish Specific Written Policies And Procedures To Ensure That Proper Documentation From Subrecipients Is Submitted To The Agency**

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State Agency: Cabinet for Families and Children

Federal Program: CFDA 93.596 – Child Care Mandatory and Matching Funds of the  
Child Care and Development Fund

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Allowable Costs/Subrecipient Monitoring

Amount of Questioned Costs: \$13,014

The Child Care and Development Fund (CCDF), of CFC, disburses grant monies to child care providers through mini-grant contracts. We tested a sample of 60 mini-grant contract payments to determine if CFC monitored them in accordance with A-133 and grant contract provisions. CFC's failure to properly monitor the mini-grant contracts resulted in known questioned costs of \$13,014. Specifically, our testing revealed the following problems with the CCDF mini-grant contracts:

- Of the 60 payments tested, payments of \$7,079 did not agree to the supporting documentation provided by the subrecipients.
- One facility was not in compliance with its contract provisions resulting in unallowable costs of \$5,935.
- Insufficient documentation was provided for personnel expenses paid to 2 providers.
- Supporting documentation did not agree to personnel expenses paid to 1 provider.
- Insufficient documentation was provided for equipment expenses paid to 4 providers.

In our opinion, CFC has failed to adequately address the aforementioned problems; thus, we conclude that the agency has materially misrepresented its corrective action plan as indicated in the FY 98 audit. The same errors and weaknesses were noted during the FY 98 audit, finding 98-CFC-39, and during the FY 97 audit, finding 97-CFC-31. According to management's response from the FY 98 audit, "... requests for reimbursement now go through a double review process. Questions identified during the review process are pursued with providers prior to authorizing of payments and providers are advised when reimbursement is either disallowed and/or deferred for payment and the reasons for the decision."



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CFC-43: The Cabinet For Families And Children Should Establish Specific Written Policies And Procedures To Ensure That Proper Documentation From Subrecipients Is Submitted To The Agency (Continued)**

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Based on the testing procedures performed on the FY 99 mini-grant contract payments, the supporting documentation provided by the subrecipients was, in fact, reconciled by CFC personnel to the amounts requested. However, due to understaffing and a lack of formalized procedures, it appears that some mini-grant contract payments were made without the agency recognizing the insufficiency of reliable and adequate supporting documentation.

The absence of proper documentation, combined with vague and unrelated documentation, prevents CFC from determining whether expenses incurred by subrecipients are for allowable costs. The likelihood that grant monies are expended for unallowable costs are increased without the presence of reliable and adequate supporting documentation.

OMB Circular No. A-133 subpart C. paragraph (b) states that the auditee (CFC) must “[M]aintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.” Both CFDA 93.596:113 and CFDA 93.575:113 state that proper grant accounting records must be maintained.

**Recommendation**

We recommend CFC:

- deny reimbursement to subrecipients who submit incomplete and inadequate documentation for expenses incurred under the mini-grants;
- properly educate and train CFC personnel and its agents assigned to review reimbursement requests; and
- establish specific written policies and procedures as to how CFC personnel and its agents should determine whether sub-recipient costs are accurate and allowable. These policies and procedures should be provided to the subrecipients to ensure that proper documentation is submitted to the agency.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CFC-43: The Cabinet For Families And Children Should Establish Specific Written Policies And Procedures To Ensure That Proper Documentation From Subrecipients Is Submitted To The Agency (Continued)**

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**Management's Response and Corrective Action Plan**

*The Cabinet for Families and Children disburses grant monies to sub-recipients, whose applications/requests for proposals were accepted through a selection process and awarded grant funding, through Child Care Provider Service Agreements (mini-grant agreements). Invoicing forms and procedures were provided to the sub-recipients by the Cabinet. The Child Care Provider Service Agreements included language that stated the sub-recipients were to maintain supporting documentation to substantiate all CCDF funds requested, and to be able to furnish said documentation upon the request of the Cabinet. There was a statement of certification on the invoice, whereby the sub-recipient in signing the form, certified that the information contained in the invoice was accurate to the best of their knowledge.*

*At the time the Contracts Management Branch received and responded to the Record of Noncompliance for SFY 98, the SFY 99 Child Care Provider Service Agreements had been distributed. There was not sufficient time to include additional language in the agreements to describe/list what accompanying documentation would have to be provided by the sub-recipients in order to be reimbursed for equipment/services under the grant.*

*The Contract Management Branch relied upon the Division of Child Care, and the Child Care Resource and Referral network to assist in providing technical assistance to the sub-recipient.*

*Upon learning of the SFY 98 Record of Noncompliance, the Contracts Management Branch became more involved by advising sub-recipient, upon receipts of phone calls and/or receipt of invoices, when additional documentation would be necessary, and when reimbursement would be either disallowed and/or deferred for payment and the reasons for the decisions. With combined cooperation of the Contracts Management Branch, the Division of Child Care, and the Child Care Resource & Referral Network, the Cabinet has become more successful in educating sub-recipients as to what accompanying documentation would be needed to support the amounts of reimbursement being requested.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CFC-43: The Cabinet For Families And Children Should Establish Specific Written Policies And Procedures To Ensure That Proper Documentation From Subrecipients Is Submitted To The Agency (Continued)**

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**Management's Response and Corrective Action Plan (Continued)**

*Although the Cabinet may not be 100% successful in its attempts of a 'double review process'. Staff contacted the sub-recipients by phone and/or by letter to resolve questions of cost of equipment, program supplies, and or service costs prior to authorizing payment. The Cabinet will continue to work to provide sub-recipients with additional information concerning the requirements of the Child Care and Development Fund, on the front end, in the Request for Proposal Packet/application process. In the future, the Cabinet will attempt to properly train CFC personnel and its agents assigned to review reimbursement requests to determine whether the sub-recipient's cost are accurate and allowable. The Cabinet will strive to establish specific written policies and procedures to determine if the sub-recipient's cost are accurate and allowable, and to extend these written policies and procedures to the sub-recipients awarded the CCDF funding.*

*The Contracts Management Branch is requesting we be provided the names of the sub-recipients where problems were found during the auditor's testing. Upon receipt of this information, our office will contact the sub-recipients and request additional and/or supporting documentation to reconcile the questioned costs. This information will then be forwarded to the Auditor of Public Accounts for review and appropriate documentation.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CWD-44: The Office Of Training And ReEmployment Should Comply With Job Training Partnership Act Regulations And OMB Circular A-133 Regarding Resolution Of Subrecipient Audit Findings**

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State Agency: Cabinet for Workforce Development

Federal Program: CFDA 17.250 - Job Training Partnership Act and CFDA 17.246  
Employment and Training Assistance – Dislocated Workers

Federal Agency: U. S. Department of Labor

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: N/A

During the FY 99 audit, we tested the audit log maintained by the Office of Training and ReEmployment (OTR) to track subrecipient monitoring related to the required audits of subrecipients. During this review, we noted several incidences in which OTR did not obtain, review, reconcile, and resolve Service Delivery Area (SDA) audits in a timely manner.

Furthermore, we noted that this is a repeat finding, which has been noted since the FY 96 audit of the JTPA program as an other matter comment. The agency's prior year corrective action plan indicated that the agency would strengthen controls over monitoring of subrecipient audits. However, our testing indicated that deficiencies within the monitoring system had not been corrected. Therefore, we are upgrading this prior other matter comment to a reportable condition and including this finding in the Schedule of Findings and Questioned Costs.

We noted the following deficiencies:

- Two incidences in which OTR did not obtain the SDA audit reports in a timely manner. The receipt of the audit reports in an untimely manner delays the entire resolution process. It also increases the likelihood that subrecipient weaknesses noted in the audit continue for a longer period of time since they are not being addressed.
- Three incidences in which OTR did not resolve subrecipients' audit report findings in a timely manner. According to the Financial Management Guide and the Federal regulations for JTPA, the agency has 180 days to resolve these matters. Again, untimely resolution of audit findings increases the likelihood that subrecipient weaknesses noted continue for a longer period of time since they are not being addressed.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS  
(CONTINUED)**

**FINDING 99-CWD-44: The Office Of Training And ReEmployment Should Comply With Job Training Partnership Act Regulations And OMB Circular A-133 Regarding Resolution Of Subrecipient Audit Findings (Continued)**

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- Ten incidences in which OTR did not determine whether the subrecipients were in compliance with OMB Circular A-133. The Audit Log maintained by the agency indicates that OTR expects to receive a Cognizant Agency letter, which would satisfy this requirement. However, OTR did not receive such letters or obtain any other assurance that subrecipients complied with OMB Circular A-133, as required by the regulations.
- Ten incidences in which the agency's records were not reconciled to the SDA's audited financial statements. This should be performed to ensure that the audited financial statements agree with the amounts reported in the agency's grant accounting records. Unreconciled financial statements lead to the potential for Federal reporting which does not agree to the financial statements on which an opinion has been given.

These repeat findings indicate that OTR has failed to implement the corrective action plans submitted in each of the past three years. Circular A-133 requires the auditor to follow up on prior audit findings, perform procedures to assess the reasonableness of the schedule of prior audit findings, and report when the summary schedule of prior audit findings materially misrepresents the status of any prior audit findings. Since the agency has repeatedly failed to implement the corrective action plans submitted, we conclude that the Summary Schedule of Prior Audit Findings for fiscal year ended June 30, 1998, for the Cabinet for Workforce Development has been materially misrepresented.

OMB A-133 states that the funding agency should be sent a copy of the audit report within the *earlier* of 30 days after [the subrecipient's] receipt of the auditor's report(s), or 13 months after the end of the audit period. This requirement is also outlined in OTR's Financial Management Guide. However, for fiscal years beginning after June 30, 1998 the requirement changes from 13 months to 9 months.

The regulations of the JTPA program [20 CFR 627.480 (d) (1) and (2)] state: "Each entity that receives JTPA program funds and awards a portion of those funds to one or more subrecipients shall: (1) Ensure that each subrecipient complies with the applicable audit requirements; and (2) Resolve all audit findings that impact the JTPA program with its subrecipient and ensure that corrective action for all such findings is instituted within 6 months after receipt of the audit report [re: resolution of findings]."

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CWD-44: The Office Of Training And ReEmployment Should Comply With Job Training Partnership Act Regulations And OMB Circular A-133 Regarding Resolution Of Subrecipient Audit Findings (Continued)**

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OMB A-133 states that the pass-through entity should consider whether subrecipient audits necessitate adjustment of the pass-through entity's own records.

The OTR Financial Management Guide states, "The SDA is responsible for the reconciliation of the audited financial statements to the JTPA program records maintained in their accounting systems."

**Recommendation**

We recommend that OTR implement procedures to ensure compliance with the JTPA regulations, OMB A-133 and the OTR Financial Management Guide regarding audit resolutions of subrecipients.

**Management's Response and Corrective Action Plan**

*The Office of Training and ReEmployment (OTR) and the Cabinet for Workforce Development recognizes the importance of complying with subrecipient monitoring requirements.*

*OTR will review the response to this comment from the prior year and take the necessary steps to ensure the corrective measures outlined last year are in place and the weaknesses in that process are strengthened.*

*The Cabinet realizes that the "technical" reviews to make certain that the audits were in compliance with A-133 requirements that were to be performed by an assigned staff person at the Cabinet level were not completed. The Cabinet is determined that these reviews will be performed by a staff person, or other arrangements will be made to get these reviews completed.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CWD-45: The Department For Adult Education And Literacy  
Should Ensure Applicable Subrecipient Audits Are Performed And Prompt Action  
Is Taken On Audit Findings**

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State Agency: Cabinet for Workforce Development

Federal Program: CFDA 84.002 - Adult Education – State Grant Program

Federal Agency: U. S. Department of Education

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: N/A

Testing of subrecipient monitoring disclosed that the Department for Adult Education and Literacy (DAEL) did not have adequate procedures in place to ensure that subrecipient audits were performed and to ensure the subrecipients took prompt corrective action on audit findings. The lack of adequate subrecipient monitoring is a control weakness and violates OMB Circular No. A-133 subrecipient monitoring requirements.

Our testing indicated that the FY 98 subrecipient audits had not been obtained or reviewed by the DAEL. The agency is required to obtain and review the audits of all subrecipients that expended more than \$300,000 for the fiscal year. Lapses in the monitoring of subrecipient audits lead to the potential of unresolved control weaknesses related to the administration and expenditure of Federal dollars. Furthermore, without this oversight of the subrecipient internal controls, DAEL may continue to award additional Federal funds to agencies that are not complying with Federal regulations in their grant administration.

For example, we obtained the FY 98 and FY 99 subrecipient audits for the Kentucky Valley Educational Cooperative and noted that it disclosed significant problems with the subrecipient's handling of grant funds. The subrecipient audit noted that transactions may not have been properly classified as to purpose and program, unapproved or inappropriate expenditures may have occurred due to missing documentation, there was inadequate documentation to show how Federal programs were charged, there existed a lack of proper segregation of duties, and an audit was not made of the Federal programs in the required time period. DAEL had not reviewed the report, nor had the agency ensured that the subrecipient took corrective action. As a result, a review of the FY 99 audit indicated the same control weaknesses existed.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS  
(CONTINUED)**

**FINDING 99-CWD-45: The Department For Adult Education And Literacy  
Should Ensure Applicable Subrecipient Audits Are Performed And Prompt Action  
Is Taken On Audit Findings (Continued)**

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CFR, Title 34, Section 80.41(3) and EDGAR, paragraph 76.700 requires that grantees comply with Federal regulations which includes OMB regulations. OMB A-133 requires that pass-through entities ensure required audits be performed and ensure subrecipients take prompt corrective action on audit findings. Subrecipients that expend \$300,000 or more during the fiscal year must obtain a single audit.

**Recommendation**

We recommend that DAEL implement procedures to ensure compliance with OMB Circular A-133 subrecipient monitoring requirements. Specifically, the agency should ensure that subrecipients, which meet the OMB A-133 threshold requirement, obtain audits within the required time period, submit audits to DAEL as required, and propose and implement corrective action for any grant related findings or for any finding relating to the overall controls of the subrecipient.

**Management's Response and Corrective Action Plan**

*The Department of Adult Education and Literacy (DAEL) and the Cabinet for Workforce Development realizes the importance of complying with the subrecipient monitoring requirement of OMB Circular A-133. Therefore there will be a joint effort between DAEL and the Division of Fiscal Services to insure that procedures are implemented to ensure compliance.*

*Specifically, DAEL will maintain a log of subrecipients and obtain audit reports or required letters in lieu of audit reports for any subrecipients. This log will note the date the audit report or letter is due; the date it is requested; the date it is received; the date it is reviewed; and the date any follow-up on findings is performed.*

*The Cabinet will work with DAEL to review the audits and letters for any grant related findings and findings relating to the overall controls of the subrecipient. The Cabinet will also provide support by providing "technical" reviews of the audits to make sure that they meet the audit requirements of A-133. The subrecipients will be notified of any concerns and follow-up of the corrective action will be monitored.*



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CWD-46: The Kentucky Office Of School To Work Should Comply With School To Work And OMB Circular A-133 Subrecipient Monitoring Requirements**

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State Agency: Cabinet for Workforce Development

Federal Program: CFDA 84.278 – School-To-Work Implementation Grant

Federal Agency: U.S. Department of Education

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: None

Several control weaknesses were noted related to the Kentucky Office of School to Work's (KOSTW) monitoring of subrecipients. These weaknesses include the following:

- KOSTW failed to properly notify subrecipients of their audit requirements under OMB A-133. The agency's financial management guide and subrecipient contract contain outdated references related to the audit requirements.
- KOSTW did not properly control the financial monitoring of subrecipients. Financial monitoring procedures did not adhere to policies in the agency's financial management guide. Furthermore, supporting workpapers for financial monitoring reports were not submitted to the agency's management for review.
- Financial monitoring reports were not followed up by the agency to ensure that corrective action plans were reasonable and were implemented by subrecipients. Three financial monitoring reports tested contained findings, for which no follow-up procedures were conducted.
- Required subrecipient audits were not reviewed for compliance with OMB A-133 or for program-related findings. As a result, corrective action for program-related findings was not initiated by the agency.
- Supporting documentation for programmatic monitoring reports was not maintained by the agency. The auditor noted that three of four reports tested did not have supporting documentation.

The failure to properly notify subrecipients of audit requirements and the failure to properly monitor the activity of subrecipients interferes with the agency's ability to ensure that Federal dollars are expended in accordance with program requirements. Furthermore, documentation should be maintained for all reports to provide evidence of monitoring and to support report conclusions.

Proper internal controls dictate that documentation be maintained to support the conclusion of reports and conclusions used to determine compliance with Federal program requirements.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CWD-46: The Kentucky Office Of School To Work Should Comply With School To Work And OMB Circular A-133 Subrecipient Monitoring Requirements (Continued)**

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34 CFR 80.40 (a) states, “Grantees must monitor grant and subgrant activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity.”

OMB Circular A-133, Section 400 (d) states, “A pass-through entity shall perform the following for the Federal awards it makes. . . (2) Advise subrecipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements as well as any supplemental requirements imposed by the pass-through entity. (3) Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved. (4) Ensure that subrecipients expending \$300,000 or more in Federal awards during the subrecipient’s fiscal year have met the audit requirements of this part for that fiscal year. (5) Issue a management decision on audit findings within six months after receipt of the subrecipient’s audit report and ensure that the subrecipient takes appropriate and timely corrective action.”

**Recommendation**

We recommend that the agency implement measures to ensure all subrecipients are properly notified of applicable regulations and policies relating to the Federal award.

Furthermore, we recommend that the agency implement controls over the monitoring of subrecipients to ensure that:

- monitoring staff follow documented policies;
- subrecipient corrective action plans are followed up;
- required subrecipient audits are obtained and reviewed;
- management decisions for all program related findings in subrecipient audits is issued; and
- proper evidential documentation is maintained.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

**SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**  
**(CONTINUED)**

**FINDING 99-CWD-46: The Kentucky Office Of School To Work Should  
Comply With School To Work And OMB Circular A-133 Subrecipient Monitoring  
Requirements (Continued)**

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**Management's Response and Corrective Action Plan**

*The Office of School-to-Work (STW) and the Cabinet for Workforce Development realizes the importance of complying with the subrecipient monitoring requirement of OMB Circular A-133. Therefore there will be a joint effort between STW and the Division of Fiscal Services to insure that procedures are implemented to ensure compliance.*

*The Cabinet will work with STW to review the audits and letters for any grant related findings and findings relating to the overall controls of the subrecipient. The Cabinet will also provide support by providing "technical" reviews of the audits to make sure that they meet the audit requirements of A-133. The subrecipients will be notified of any concerns and follow-up of the corrective action will be monitored.*

**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS**

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions</u></b>					
<i>(1) Audit findings that have been fully corrected:</i>					
FY 98	98-C&I-3	Office Of Financial Management And Economic Analysis Should Ensure The Investment System Is Year 2000 Compliant	N/A	0	Resolved during FY 99.
FY 98	98-CFC-16	The Cabinet For Families And Children Should Increase Efforts To Discover And Recover Overpayments And Duplicate Payments Made To Child Care Providers Through The Child Care And Development Fund	93.596	0	Resolved during FY 99.
FY 98	98-CFC-19	The Cabinet For Families And Children Should Improve Efforts To Document Procedures For Low Income Home Energy Assistance Branch	93.568	0	Resolved during FY 99.
FY 98	98-CFC-20	The Cabinet For Families And Children Should Develop And Enforce Strict Sanctions In Relation To The Social Services Block Grant	93.667	0	Resolved during FY 99.
FY 98	98-CFC-22	The Cabinet For Families And Children Should Develop A System To Track TANF Recipients Who Refuse To Cooperate In Establishing Paternity	96.558	0	Resolved during FY 99.
FY 98	98-CFC-23	The Cabinet For Families And Children Should Monitor Day Care Centers That Receive Grant Monies Through The Child Care And Development Fund	93.596	0	Resolved during FY 99.
FY 98	98-CFC-30	The Division Of Child Care Should Continue To Monitor, Upgrade, And Test All Systems To Ensure Accurate Processing In The Year 2000	N/A	0	Agency satisfactorily continued toward Y2K readiness and had no major rollover problems.
FY 97	97-CFC-41	The Division Of Disability Determinations Should Improve Logical Access Security Procedures	N/A	0	No exceptions noted in FY99.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(1) Audit findings that have been fully corrected (Continued):</i>					
FY 97	97-CFC-43	The Division Of Disability Determinations Should Ensure All Modifications Are Completed to Allow Processing In The Year 2000	N/A	0	Agency satisfactorily continued toward Y2K readiness and had no major rollover problems.
FY 96	97-FAC-2	The Finance And Administration Cabinet Should Adequately Document And Improve Procedures For Preparing The Comprehensive Annual Financial Report	N/A	0	Resolved during FY 99.
FY 97	97-CHS-46	The Department For Medicaid Services Should Ensure That The State Worker's Compensation Data Exchange Occurs Between The Labor Cabinet And The Department For Medicaid Services	N/A	0	Resolved for FY 99.
FY 98	98-KHESLC-35	Loans Submitted On ED Form 799 Should Be Properly Categorized	82.032	\$1,000,000	Resolved for FY 99.
FY 98	98-NREPC-37	The Natural Resources And Environmental Protection Cabinet Should Improve Controls Over Preparation Of The Schedule Of Expenditures Of Federal Awards	N/A	0	Resolved during FY 99.
FY 98	98-TC-38	The Transportation Cabinet Should Reimburse The Federal Government For Relocation Assistance Payments That Were Incorrectly Billed	20.205	\$24,000	The corrective action plan was implemented in FY 99. The questioned cost has been repaid in full to the Federal government.
FY 97	97-TC-52	The Transportation Cabinet Should Deposit Sale Proceeds Timely	20.205	0	The corrective action plan was implemented during FY 99.
FY 98	98-WFDC-10	The Cabinet for Workforce Development Should Improve Logical Access Security Procedures For The Unemployment Insurance Systems	N/A	0	Resolved during FY 99.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<b><i>(2) Audit findings not corrected or partially corrected:</i></b>					
FY 98	98-C&I -2	Department Of Treasury And Finance And Administration Cabinet Should Enhance Reconciliation Procedures	N/A	0	The FAC's and Treasury's Investment Portfolios will disappear with the implementation of MARS on July 1, 1999. There will no longer be a reconciliation to be done. All investment information will be housed in the Office of Financial Management and Economic Analysis' CAMRA System.
FY 98	98-CFC-17	The Cabinet For Families And Children Should Submit Federal Reports In A Timely Manner	10.561	0	The Food Coupon Accountability Report (FNS-250), for 3 <sup>rd</sup> quarter of FY99, was not submitted timely. The agency has implemented statewide Electronic Benefit Transfer system which should alleviate delayed submission of the FNS-250 Reports.
FY 98	98-CFC-18	The Cabinet For Families And Children Should Improve Efforts To Enforce The Policies In Relation To The State Administrative Matching Grants For The Food Stamps Program	10.561	0	Twenty-four of sixty claims tested were not established within six months of the discovery date. The agency will implement a review process by management review officers to ensure that all errors are identified and corrected. The management review officers will also review a sample of potential claims. Finally, the agency will provide claims data reports to the Service Region Administrators.
FY 98	98-CFC-21	The Cabinet For Families And Children Should Integrate Systems To Improve The Claims Process For The TANF Program	96.558	0	CFC is currently working on integrating the KCA and KCL databases. Completion is expected by September 2000.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 1999  
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<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<b><i>(2) Audit findings not corrected or partially corrected (Continued):</i></b>					
FY 98	98-CFC-24	The Cabinet For Families And Children Should Maintain All	93.596	0	We noted questioned costs of \$1,847 for FY 99 and payments for ineligible children, missing DSS-76 forms, seven files that did not contain birth certificates, and three DSS-76 forms that were not signed. The agency is scheduling for distribution in July 2000, a revised handbook which specifies required documentation to be maintained in the case files. The various related divisions will be working together to ensure that referrals are appropriately made, that forms are appropriately completed, and that any changes are properly communicated between all involved agencies.
FY 99		Billing And Eligibility Documentation To Support Payments To Families Receiving Assistance From The Child Care And Development Fund		1,847	
Total Questioned Costs				<u>\$1,847</u>	
FY 98	98-CFC-25	The Cabinet For Families And Children Should Maintain Adequate Records To Ensure Compliance With Health And Safety Requirements	93.596	0	We were unable to determine whether CFC or service agencies acted to terminate payments to providers who failed to enroll. The agency notes changes in KCCMS to distinguish between relative and enrolled providers were implemented 4/1/2000. The enrollment program is being enhanced and will be more closely monitored by the Division of Child Care and Service Agent staff. Better procedures will be implemented to track who receives applications to become an enrolled provider, when the application is received, and the Service Agent counselor issuing the application.



**COMMONWEALTH OF KENTUCKY**  
**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS**  
**FOR THE YEAR ENDED JUNE 30, 1999**  
**(CONTINUED)**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(2) Audit findings not corrected or partially corrected (Continued):</i>					
FY 98	98-CFC-26	The Cabinet For Families And Children Should Ensure That Complete Records Are Maintained For TANF Recipients	96.558	0	Missing case files, clerical errors, and incomplete documentation were noted during FY 99. CFC has been working with GOT and OTS to automate the claims process. This interfacing should be completed and implemented by September 2000.
FY 98	98-CFC-27	The Cabinet For Families And Children Should Maintain Records To Support Payments To Participants In The Kentucky Works Program	93.558	0	Missing case files, clerical errors, and incomplete documentation were noted during FY 99. CFC is in the process of revising the PA-32 form to limit the number of items on the form and to be more specific in the instructions to the provider. Additionally, the information used in completing the PA-33 form will be eliminated now because Kentucky contracts out transportation services. This form also will be revised.
FY 98	98-CFC-28	The Department For Social Insurance Should Implement Procedures To Ensure Adequate Supporting Documentation Is Maintained	93.658	\$4,325	For FY 99 the lack of DSS-111A or DSS-114 forms resulted in known questioned costs of \$12,963. The agency will look into the noted exceptions to determine a corrective action plan. In the interim, the agency has scheduled a training session to include the audit issues in order to facilitate improved maintenance of the records and required documentation.
FY 99				12,963	
Total Questioned Costs				<u>\$17,288</u>	

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
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(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<b><i>(2) Audit findings not corrected or partially corrected (Continued):</i></b>					
FY 98	98-CFC-29	The Cabinet For Families And Children Should Implement Adequate Procedures To Ensure The Accuracy And Completeness Of KCCMS Generated Interface Files And Check Tape	N/A	0	Significant content change. More problems were noted concerning processing controls than were covered in the FY 98 comment.  Questioned costs involved, see finding 99-CFC-34.
FY 98	98-CFC-31	The Division Of Child Care Should Consistently Follow Logical Security Procedures For The Kentucky Child Care Management System	N/A	0	No significant improvements were made during FY 99. The agency will develop, publish, and distribute formal procedures to document the steps for requesting access and obtaining access to KCCMS.
FY 98	98-CFC-32	The Division Of Child Care Should Complete The Development Of A Formal Disaster Recovery Plan	N/A	0	Due to improvements, downgraded comment status to "other matters."
FY97	97-CFC-33	Discovery And Collection Of Overpayments Of TANF Funds Should Be Identified And Pursued Promptly To Maximize Recovery	93.558	\$23,175	See comments for 98-CFC-21.
FY 97	97-CFC-34	The Department For Social Insurance Should Implement Procedures To Ensure Adequate Documentation Exists For Transportation Payments To Participants	93.558	\$1,290	See comments for 98-CFC-26.
FY 97	97-CFC-35	The Department For Social Insurance Should Implement Procedures To Ensure Adequate Supporting Documentation Is Maintained	93.558	\$777	See comments for 98-CFC-27.
FY 97	97-CFC-36	The Department For Social Insurance Should Implement Procedures To Ensure Adequate Supporting Documentation Is Maintained	93.658	0	See comments for 98-CFC-28.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
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(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(2) Audit findings not corrected or partially corrected (Continued):</i>					
FY 97	97-CFC-40	The Division Of Disability Determinations Should Implement A Security Policy	N/A	0	Significant improvements made with logical security and no exceptions noted, but a formal policy had not been implemented for FY 99. Due to improvements, downgraded comment status to "other matters."
FY 98	98-FAC-5	The Division Of Purchases Did Not Adequately Control Access To KAPS	N/A	0	Access provided did not ensure proper segregation of duties. Programmers with update access to production data and/or job control libraries were noted as a weakness. The agency notes that KAPS has been decommissioned and replaced by MARS. The KAPS critical components have been replaced by the Procurement Desktop application of MARS. The MARS Security Administrator within the Office of the Controller maintains all user ids, roles, and levels of access to the MARS applications and data.
FY 98	98-FAC-6	The Division Of Purchases Should Implement Automatic Log-Off Security For KAPS	N/A	0	Due to the sensitive nature of KAPS data, it is vital that this security function be activated to reduce the risk of unauthorized access. The agency notes that KAPS has been decommissioned and replaced by MARS. The KAPS critical components have been replaced by the Procurement Desktop application of MARS. An automatic log-off procedure has been implemented for the Advantage application of MARS.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(2) Audit findings not corrected or partially corrected (Continued):</i>					
FY 98	98-FAC-7	The Division Of Purchases Should Improve Logical Access Security For KAPS	N/A	0	Policies and procedures had not been developed to identify management and user responsibilities for system security. The agency notes that KAPS has been decommissioned and replaced by MARS. The KAPS critical components have been replaced by the Procurement Desktop application of MARS. The written procedures for MARS security administration is documented in MARS Central and Agency Security Administrator's Guide. This function is now performed by the MARS Security Administrator within the Office of the Controller.
FY 97	97-FAC-4	The Finance And Administration Cabinet's Division Of Accounts Should Consistently Follow Procedures To Ensure Accurate Program Modifications	N/A	0	During FY 99 testing, the inconsistent application of program modification control procedures was again noted. The agency plan for debugging and bringing in planned system modifications by AMS has created the necessity for AMS to execute changes, test, and bring into production due to our limited knowledge of the system. As our GOT production staff is gaining experience, we are working off the above situation and locking AMS ID's out, setting the stage for a normal production environment.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(2) Audit findings not corrected or partially corrected (Continued):</i>					
FY 96	97-FAC-6	The Finance And Administration Cabinet Should Provide Adequate Access Security For The Statewide Accounting And Reporting System	N/A	0	Users were granted access without proper documentation on file with FAC and DIS employees with access to FAC databases. In addition, it was noted that FAC was not updating records with DIS for changes of users for the same user ID. The agency is moving toward the security model where the programmers can't update the database without special approval or move code to production.
FY 98	98-CHS/ CDP-1	Custom Data Processing, Inc., Should Improve Logical Access Security Procedures For The Cabinet For Health Services System Applications	N/A	0	There have not been any changes to CDP programmer's unrestricted access to programs and data. CDP has already or will implement several additional recommended controls noted in the audit. Subsequent audits should indicate that procedures are in place and working adequately.
FY 98	98-CHS-33	Subrecipient Monitoring Procedures At The Department For Public Health Should Be Improved	N/A	0	No review of local health departments has been performed by the agency as of FY 99.  See finding 99-CHS-37.
FY 98	98-CHS-34	The Department Of Public Health Should Develop Written Policies And Procedures For Significant Areas Of The Immunization Program	N/A	0	A program administrator was hired and is currently working on developing a written policies and procedures manual.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<b><i>(2) Audit findings not corrected or partially corrected (Continued):</i></b>					
FY 97	97-CHS-44	The Department For Medicaid Services Should Improve The Controls Over Drug Rebate Billings, Collection, and Recording	N/A	0	The agency is in the process of implementing our recommendations. However, other findings were noted in our testing.  See finding 99-CHS-36.
FY 97	97-CHS-47	The Finance And Administration Cabinet And The Cabinet For Health Services Should Develop Procedures To Ensure Vendors Providing Services To Federal Programs Are Not Debarred Or Suspended By The Federal Government	N/A	0	MARS will have the capability to identify debarred/suspended vendors. The agency will implement this finding July 1, 1999 when MARS is implemented.
FY 97	97-CHS-48	The Division Of Substance Abuse Should Adhere To Established Internal Control Procedures	N/A	0	A log is now maintained of all grant progress reports. Progress reports are then distributed to appropriate staff for review. However, no procedure has been implemented to send reminder notices for delinquent reports.
FY 97	97-CHS-49	The Department For Public Health Should Develop A Complete Information System Security Policy	N/A	0	Some corrective action has been taken although not sufficient to resolve the finding.
FY 98	98-MA-36	The Department Of Military Affairs Should Strengthen Procedures For Monitoring Subrecipients	83.544	0	The Department of Military Affairs has made improvements in their tracking system; however, audits are not being date stamped or reviewed and resolved in a timely manner.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<b><i>(2) Audit findings not corrected or partially corrected (Continued):</i></b>					
FY 97	97-Military Affairs-50	The Department Of Military Affairs Should Strengthen Procedures For Monitoring Subrecipients	83.544		See comments for 98-MA-36 above.
			83.544	\$62,500	Bell County violated FEMA policy 44CFR206.402(4) Salvage and Reuse of Structure acquired through the HMPG. Five of seven mobile homes purchased to be destroyed were returned to owners. Estimated value of each mobile home was \$12,500. Currently, the Department of Military Affairs is working with the County Judge to resolve the issue.
FY 98	98-KSFB-8	General Ledger Accounts Should Be Analyzed And Reconciled To Underlying And Supporting Records On A Timely Basis	N/A	0	During FY 99, we noted improvement in this area. However, we still do not believe the performance in this area is at the level it should be.  Account balances at 6/30/99 were reconciled to the general ledger between 7/99 and 11/99. The reconciliation process resulted in numerous adjustments to the general ledger before the financial statements could be prepared, some of which were sizable.
FY 98	98-PERS-9	The Personnel Cabinet Should Implement Adequate Logical Access Security For The Unified Personnel And Payroll System	N/A	0	Exceptions were again noted during the Application Access System testing for FY 99. Personnel Administration agreed to change access to read only for DIS Librarians and Programmers.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 1999  
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<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(2) Audit findings not corrected or partially corrected (Continued):</i>					
FY 94	97-Personnel-8	Logical Access Control Over The Unified Personnel And Payroll System Should Be Strengthened	N/A	0	The agency has not yet resolved the problem.  See comment for 98-PERS-9.
FY 97	97-Personnel-10	The Personnel Cabinet Should Complete A Disaster Contingency Plan	N/A	0	The agency has drafted a specific internal Business Continuity Plan for Payroll Production that will apply directly to the year 2000 rollover. This proprietary plan will serve well for future efforts in documenting a complete Disaster Recovery Plan for Uniform Personnel and Payroll System (UPPS).
FY 97	97-WFDC-53	The Cabinet For Workforce Development Should Ensure The Job Training Partnership Act Complies With Earmarking Requirements	17.246	\$ 42,039	Finding unresolved in FY 99. No additional costs were questioned in FY 99, but the agency has not resolved outstanding questioned costs.
FY 98				60,546	
		Total Questioned Costs Remaining		<u>\$102,585</u>	
FY 96	N/A	The Department For Medicaid Services Should Improve Internal Controls Relating To The Alternative Intermediate Care/Mental Retardation Waiver	N/A	120,760	The agency implemented its correction action plan for FY 97. However, the questioned cost has not been resolved.



**COMMONWEALTH OF KENTUCKY  
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<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(3) Corrective action taken is significantly different from corrective action previously reported:</i>					
FY 97	97-CFC-42	The Division Of Disability Determinations Should Improve Program Modification Procedures	N/A	0	<p>The agency has made progress toward complying with audit recommendations, but has yet to fully implement formal policies and procedures. Our follow-up work related to this finding indicated that the Department understands the significance of the noted problem, and has taken different corrective action measures in an attempt to alleviate the problems noted. Therefore, based on this information we will show the text of the finding and the new corrective action plan as a new finding.</p> <p>See Finding 99-CFC-35.</p>
<i>(4) Audit finding is no longer valid:</i>					
FY 98	98-FAC-4	Finance And Administration Cabinet Should Prevent Inappropriate Disbursement Of Funds And Duplicate Payments By Maintaining Adequate Documentation To Support Transactions And Strengthening Pre-audit Reviews	N/A	0	<p>Due to circumstances beyond the responding agency's control, its response to this prior year finding was not included in the FY98 SSWAK Report. Thus, we will include as current year findings any findings that may have been related to this finding.</p> <p>See 99-FAC-7, 9, 10, 12, 14, and 19 in the Schedule of Findings and Questioned Costs.</p>

**COMMONWEALTH OF KENTUCKY  
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<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Material Weaknesses/Noncompliances</u></b>					
<i>(1) Audit findings that have been fully corrected:</i>					
FY 98	98-CFC-41	The Cabinet For Families And Children Should Improve Accuracy In Billing And Eligibility Determination Functions For The Child Care And Development Fund	93.596	\$3,322,325	Resolved during FY 99.
FY 97	97-CHS-54	The Department For Medicaid Services Should Develop Controls To Monitor The Third Party Liability Function Performed By The Fiscal Agent	N/A	0	Resolved for FY 99.
FY 98	98-PERS-15	The Personnel Cabinet Should Ensure Conversion Of All Critical Systems To Be Year 2000 Compliant	N/A	0	Resolved for FY 99.
FY 96	97-REV-26	The Revenue Cabinet Needs To Improve Tracking Procedures For Contingent Liabilities	N/A	0	The Status of Pending Cases Report has been combined with the Assignment sheet. This report contains all information needed to better track contingent liabilities.
<i>(2) Audit findings not corrected or partially corrected:</i>					
FY 98	98-CFC-39	The Cabinet For Families And Children Should Monitor Payment Requests Submitted By Subrecipients To Ensure That Grant Monies Are Spent In Accordance With Contract Provisions	93.596 and 93.575	\$5,240,535	Our audit showed this finding was not resolved during FY 99. Similar errors and weaknesses still exist. Corrective action as submitted from the agency was not effective in mitigating these problems.  See Finding 99-CFC-43.

**COMMONWEALTH OF KENTUCKY  
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<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Material Weaknesses/Noncompliances (Continued)</u></b>					
<b><i>(2) Audit findings not corrected or partially corrected (Continued):</i></b>					
FY 98	98-CFC-40	The Cabinet For Families And Children Should Adhere To Established System Development Life Cycle Controls For Development And Implementation Of New Systems	93.575	\$3,023,137	The audit comment and questioned costs are applicable to FY 98 only. The amount of questioned costs remains unresolved. No further action taken. There was no major system implementation in FY 99.
FY 97	97-CFC-31	Sufficient Supporting Documentation Should Be Maintained For Child Care Development Expenditures	93.575	\$49,214	See comments for 98-CFC-39.
FY 98	98-FAC-13	The Division Of Purchases Microcomputers Are Not Fully Year 2000 Compliant	N/A	0	The agency has completed compliance conversion and testing. The comment was downgraded to a verbal comment.
FY 98	98-FAC-14	The Finance And Administration Cabinet Should Continue To Take Necessary Measures To Ensure The STARS System Is Replaced Or Is Made Year 2000 Ready	N/A	0	The STARS system was replaced in July 1999 by the MARS system. In addition, the STARS system was made Year 2000 compliant with the exception of the Reporting Module. This module was replaced by a Management Report Writing Database and should be Year 2000 compliant. This comment has been downgraded to a verbal comment for FY 1999.
FY 98	98-CHS/ CDP-11	Custom Data Processing, Inc., Should Update All Systems To Be Year 2000 Compliant	N/A	0	Progress was made in this area. The comment has been downgraded to an "other matter" for FY 99.

**COMMONWEALTH OF KENTUCKY  
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(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Material Weaknesses/Noncompliances (Continued)</u></b>					
<b><i>(2) Audit findings not corrected or partially corrected (Continued):</i></b>					
FY 98	98-CHS-42	The Department Of Public Health Should Strengthen Controls Over The Vaccine Inventory System	93.268	0	Progress has been made by the agency to improve their inventory system. Reconciliation procedures should be in place for review prior to FY 2000 audit.
FY 97	97-CHS-55	The Department For Medicaid Services Should Establish Procedures To Ensure That Pharmacy Provider Information Is Accurate And Current In The Medicaid Management Information System	N/A	184,633	The FY 97 and FY 98 questioned costs, totaling \$486,813, were resolved. Monthly reports should be obtained from the Kentucky Board of Pharmacy This finding has been downgraded to an "other matter."
FY 98				302,180	
		Total Questioned Costs Resolved		<u>\$486,813</u>	
FY 98	98-DIS-12	The Department Of Information Systems Should Continue Efforts With The Agencies To Ensure All Vendor And DIS Provided Applications And Systems Are Compliant With The Year 2000	N/A	0	Progress was made in this area. The comment has been downgraded to an "other matter" for FY 99.
FY 97	97-KY KARE-21	Controls Over Receipts Should Be Strengthened At Kentucky Kare	N/A	0	The Commonwealth discontinued Ky Kare for calendar year 1999. As of April 30, 1999, Ky Kare had no active contracts. Third Party Administrators will continue paying claims incurred for the last plan year (1998).
FY 95	97-REV-24	The Revenue Cabinet Should Utilize The Automatic Log-Off Feature For Information Management Systems And Customer Information Control System Applications	N/A	0	The agency drafted a password protected screen saver use policy during FY 99. The comment has been downgraded to an Other Matters issue.

**COMMONWEALTH OF KENTUCKY  
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(CONTINUED)**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Material Weaknesses/Noncompliances (Continued)</u>					
<i>(2) Audit findings not corrected or partially corrected (Continued):</i>					
FY 96	97-REV-25	The Revenue Cabinet Computer System Must Be Modified In Order To Process Year 2000 Data	N/A	0	The agency has completed compliance conversion and testing. The comment was downgraded to a verbal comment.
FY 93	N/A	The Cabinet For Workforce Development Had Questioned Costs of \$372,383 For Fiscal Years Ended June 30, 1993	Multiple Programs	\$372,383	DES resolved \$73,749 during FY 97 and \$39,254 during FY 98. There was no resolution of the remaining \$259,380 during FY 99. The agency has provided documents of FY 00 transactions which may resolve the remaining costs during the FY 00 audit.
FY 97				(73,749)	
FY 98				(39,254)	
Total Questioned Costs Remaining				<u>\$259,380</u>	

***(3) Corrective action taken is significantly different from corrective action previously reported:***

No findings for this section.

***(4) Audit finding is no longer valid:***

No findings for this section.

## **APPENDIX**

**COMMONWEALTH OF KENTUCKY  
APPENDIX  
FOR THE YEAR ENDED JUNE 30, 1999**

List Of Agencies Audited As Part Of The Single Statewide Audit Of the Commonwealth

The list includes agencies receiving only financial statement audits used for preparing the Commonwealth's Comprehensive Annual Financial Report (CAFR). CPA reports are available upon request to the respective audited agency.

**AGENCIES AUDITED BY CERTIFIED PUBLIC ACCOUNTING FIRMS AND INCLUDED IN THE SSWAK:**

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Bluegrass State Skills Corporation  
Kentucky Center for the Arts Corporation  
Kentucky Economic Development Finance Authority  
Commonwealth Small Business Development Corporation  
Eastern Kentucky Exposition Center Corporation  
Kentucky Educational Savings Plan Trust  
Kentucky Authority for Educational Television and Kentucky Educational Television Foundation  
Governor's Office for Technology (formerly Department of Information Systems)  
Kentucky Higher Education Assistance Authority  
Kentucky Higher Education Student Loan Corporation  
Kentucky Horse Park  
Kentucky Housing Corporation  
Kentucky Infrastructure Authority  
Judicial Form Retirement System  
Kentucky Local Correctional Facilities Construction Authority  
Kentucky Lottery Corporation  
Office of the Petroleum Storage Tank Environmental Assurance Fund  
Kentucky Public Employees' Deferred Compensation Authority  
Kentucky Retirement Systems  
Kentucky State Fair Board  
Teachers' Retirement Systems  
Transportation Cabinet  
Turnpike Authority of Kentucky  
Kentucky Worker's Compensation Funding Commission  
Kentucky Worker's Compensation Special Fund, Coal Workers' Pneumoconiosis Fund (functions of the Labor Cabinet), and Uninsured Employers' Fund (function of the Office of the Attorney General)

**COMMONWEALTH OF KENTUCKY  
APPENDIX  
FOR THE YEAR ENDED JUNE 30, 1999  
(CONTINUED)**

List Of Agencies Audited As Part Of The Single Statewide Audit Of the Commonwealth  
(Continued)

**AGENCIES AUDITED BY CERTIFIED PUBLIC ACCOUNTING FIRMS AND  
NOT INCLUDED IN THE SSWAK EXCEPT FOR EXPENDITURE AMOUNTS:**

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Eastern Kentucky University  
Kentucky Community Technical College System  
Kentucky State University  
Morehead State University  
Murray State University  
Northern Kentucky University  
University of Kentucky  
University of Louisville  
Western Kentucky University

**AGENCIES AUDITED BY THE AUDITOR OF PUBLIC ACCOUNTS OFFICE:**

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Cabinet for Families and Children  
Cabinet for Health Services  
Department of Education  
Department for Local Government  
Finance and Administration Cabinet  
Governor's Office for Policy and Management  
Department of Military Affairs  
Natural Resources and Environmental Protection Cabinet  
Personnel Cabinet – Administrative Office of the Courts, Department of Corrections,  
Risk Management Funds, and Department of State Police  
Revenue Cabinet  
Transportation Cabinet  
Office of the Kentucky State Treasurer - Cash and Investment Functions  
Cabinet for Workforce Development

**OTHER AUDITS RELIED ON BY APA AUDITORS:**

Custom Data Processing, Inc.